

TAKE IT OR LEAVE IT:

PARTY NOT ENDING FOR PAYDAY LENDING

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*For Tyler*

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## *Abstract*

*This thesis analyses the effectiveness of the current New Zealand consumer credit protection legislation for third tier credit standard form contracts. This thesis argues that the current legislative protection under the Credit Contracts and Consumer Finance Act 2003, the Credit Contracts Legislation Amendment Act 2019 and the unfair terms provisions of the Fair Trading Act 1986 is not providing sufficient protection in the specific case of payday loan standard form contracts. This insufficient protection is allowing continued detriment to some particularly vulnerable users of these contracts, which often results in debt spirals, severe hardship and poverty. This thesis suggests that this is largely due to two factors: 1) ineffectiveness of categorising some users of payday loan standard form contracts as general consumers, and 2) inefficacy of the recently enacted Credit Contracts Legislation Amendment Act 2019.*

*The first factor is that it is not appropriate to class some users of payday loan standard form contracts as general consumers. With the exception of the Credit Contracts Legislation Amendment Act 2019, which has the purpose of protecting vulnerable users of third tier consumer credit contracts, the purposes of the current consumer credit protections is to protect the general consumer. The protection that these statutes provide, although likely adequate for the general consumer, are insufficient for some particularly vulnerable users of payday loan standard form contracts, which this thesis defines as payday borrowers. It is submitted that the payday borrower, due to their extreme external and internal vulnerability, their inevitable harm from entering payday loan standard form contracts, the severity of that harm, and unavoidableness of that harm, ought to be treated as a separate class of consumer for the purposes of consumer credit protection. As a separate class of consumer, they require increased consumer credit protection, beyond that required for the general consumer.*

*The second factor is that the recently enacted Credit Contracts Legislation Amendment Act 2019, which was enacted for the purpose of increasing protection to third tier borrowers by assisting them in obtaining credit for a fair price, will likely not achieve its purpose. This statute places a total cost of credit cap of 100% on all high cost loans, as well as an interest rate cap of 0.8% per day on all interest and fees. It is submitted that placing a cap on interest, fees and total costs recoupable upon the loan does not necessarily equate to a fair or correct cost of credit to the borrower. Not only this, but it also risks unfairness to the lender, which may cause the lender to respond in a detrimental way towards the payday borrower which will increase their hardship.*

*The current thesis found that the likely responses from payday lenders to the cost of credit caps imposed by the Credit Contracts Legislation Amendment Act 2019 are: 1) refusing to extend credit to some payday borrowers, and 2) increased use and reliance on wage garnishment.*

*Should lenders suddenly refuse to lend credit to payday borrowers, these borrowers will lose their only available line of credit. It is submitted that credit is a need for all consumers, including those financially excluded from mainstream credit and confined to third tier credit options, and without an alternative credit option available hardship and desperation will increase.*

*Should lenders choose to continue to lend credit with the imposed cost of credit restrictions, it is suggested that the lender response will be increased use and reliance on wage garnishment. Wage garnishment is a tool which lenders have available to them to recoup outstanding monies owed on a loan and is used through the inclusions of the wage garnishment term within their standard form contracts. The use of the wage garnishment term can, and often does, cause substantial hardship to payday borrowers. It is submitted that the use of this term ought to be restricted.*

*In summary, the current thesis advises that in achieving an effective form of protection for payday borrowers which will reduce problem debt and hardship, the focus of the protection must be on the objective fairness of the price of credit, rather than caps and maximum limits on the price of credit. It is submitted that a means of achieving this is through an amendment to the unfair terms provisions of the Fair Trading Act 1986 in allowing upfront price to be challenged for unfairness in the case of third tier credit contracts.*

“...the freedom was all on the side of the big concern which had the use of the printing press. No freedom for the little man who took the ticket or order form or invoice. The big concern said, ‘Take it or leave it.’ The little man had no option but to take it.”<sup>1</sup>

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<sup>1</sup> *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] QB 284, 297, per Lord Denning.



## ***1. Introduction***

Frequent users of third tier credit often find themselves in situations where they cannot meet the financial demands of repaying their debts. This can lead to debt spirals which are extremely difficult to recover from and often lead to extreme hardship. This has been an on-going concern for decades in New Zealand and many attempts have been made by the Government to protect borrowers from this harm.

This thesis will submit that frequent users of third tier credit remain under-protected in New Zealand, despite the current consumer credit protection laws in place in New Zealand. This thesis will submit that the recent enactment of the Credit Contracts Legislation Amendment Act 2019 and the amendment to the Fair Trading Act 1986 which provides provisions for unfair terms through the Fair Trading Amendment Act 2013 is insufficient to adequately protect these borrowers.

The particular third tier borrower which this thesis will focus on is an extremely vulnerable class of borrower which this thesis will refer to as a payday borrower (“PB”). The PB will be defined by their exclusive and vulnerable characteristics, being a low income earner, with limited assets, financially excluded from non-third tier credit and a frequent user of third tier credit. The type of third tier credit which will be focussed on is short-term, high-cost credit obtained from a payday lender and made available through the use of a standard form contract (“SFC”), which this thesis will refer to as a payday loan (“PL”).

The reason this thesis will give for the PB remaining under-protected when using a PL SFC is that the total price of the credit under the PL SFC remains unfair. It is submitted that in order to adequately protect the PB, there must be protection granted to them which specifically prohibits unfair pricing on this credit. This thesis will argue that placing a cap on the interest rate and a cap on the total amount recoupable on the PL does not equate to a fair price for the

credit and also leads to increased hardships for PBs. One increased hardship is the increased use of wage garnishment, which is currently available to payday lenders as a tool to recoup monies owed on outstanding debts through the inclusion of the wage garnishment (“WG”) term included in PL SFCs. This thesis will submit that the WG term is currently being used unfairly against the PB and is causing substantial hardship, yet the use of this term will increase with new caps in place that limit the amount that a payday lender can charge under their SFCs.

This thesis will be divided into four main sections.

The first section will investigate consumer vulnerability and the need for consumer legislative protections for the general consumer. This will begin by investigating the justifications for this protection, including the shortfalls of classic contract theory (“CCT”) and its free market protections, and the narrowness of procedural protections available at common law and through equitable doctrines. Following this, this section will investigate the nature of SFCs, the bounded rationality of the general consumer when using SFCs, and the significance of unequal bargaining power when a weaker party contracts with a significantly stronger party. Through this process the payday lending industry will be examined, as well as the typical characteristics of the PB. The purpose of Section One is predominately to determine whether it is justified to extend the same level of consumer credit protection to all terms within a SFC, or whether certain terms ought not to be protected to the same extent as others.

The second section of this thesis will investigate whether there is a justification to treat a PB as a separate class of consumer for the purposes of extending them increased legislative protection beyond that of the general consumer. In conducting this investigation, four factors will be submitted in favour of treating the PB as a separate class of consumer when entering a PL SFC. The first factor is that the PB enters the PL SFC involuntarily. In establishing this, it will be submitted that credit is a need rather than a want, and with the PB financially excluded from all other forms of credit, they must use the PL SFC. It will also be submitted that there is no substantial difference between the SFCs being currently used by payday lenders in the market, meaning that the PB has no meaningful choice within the credit marketplace.

The second reason is that when the PB enters a PL SFC their situation will always deteriorate. When the general consumer enters a contract they will usually gain a tangible benefit which will improve their situation, solve a problem, or obtain a desired product or service. It is submitted that this is seldom the case when a PB enters a PL SFC, as the PB will almost always be worse off. This equates to the PL SFC being a non-beneficial and inappropriate product for the PB. What is more, the PB will often not even have the expectation of gaining a benefit from the PL SFC. Instead, they simply enter the PL SFC for temporary relief, knowing their situation will be ultimately worse later.

The third reason is that the essentially inevitable harm caused by the inappropriate PL SFC is particularly severe for the PB. In demonstrating this, an investigation into child poverty will be conducted, revealing the severe harm debt spirals can cause to the children of parents who experience financial hardship. It will be submitted that the typical PB is over-represented within those suffering from extreme poverty within New Zealand and that it is the children of these PBs who are often the unrecognised victims of the extreme harm that PBs experience.

The final reason that will be given to treat the PB as a separate class of consumer is their inability to avoid the harm caused by the PL SFC. It will be submitted that this is due to fundamental differences in self-protection skills and attitudes between the PB and the general consumer. This stems from the PB's internal vulnerability, which causes them to routinely disregard important information which ought to be examined, and is examined, by the general consumer. It will be suggested that attempting to protect the PB through encouraging improved financial literacy will be an impotent solution to improving the PB's self-protection skills, or improve their ability to recover from financial hardship.

The third section of this thesis will examine the current legislative consumer credit protections available in New Zealand. Specifically, the pieces of legislation that will be examined are the proposed changes through the Fair Trading Amendment Bill 2019 in relation to unconscionable conduct, the Credit Contracts and Consumer Finance Act 2003 in relation to oppressive credit contracts, the Credit Contracts Legislation Amendment Act 2019 in relation to interest rate caps and cost of credit caps, and the Fair Trading Act 1986 and Fair Trading Amendment Act

2013 in relation to unfair terms in SFCs. An analysis will be conducted to determine whether these pieces of legislative protection are effective in achieving their goals and purposes, and whether they collectively give sufficient protection to the general consumer when entering PL SFCs. Crucially, an analysis will be made to determine whether the protection that these pieces of legislation collectively provide is sufficient to also protect the PB as a separate class of consumer. This will be in relation to obtaining a fair price for credit obtained from a PL SFC and appropriate use of the WG term as a tool to recoup monies on outstanding debts. In determining this an investigation into wage garnishing will also be conducted.

The fourth section of this thesis will suggest an alternative that will grant more appropriate protection to the PB and minimise their hardship from requiring the credit of PL SFC until an alternative credit option becomes available to them. This section will suggest that the most appropriate and beneficial protection to the PB is to enable them to challenge the total price of the PL. It will be submitted that the best way to achieve this is to amend the unfair terms provisions of the Fair Trading Amendment Act 2013 and Fair Trading Act 1986 to allow price to be treated as a non-exempt term and able to be challenged for unfairness in the case of third tier credit SFCs.

It will be submitted that although this suggested alternative will not prohibit payday lenders from unfairly pricing their PLs, this will provide the PB with a line of recourse when contractually bound to an unfair cost of credit which they cannot reasonably repay. This will then provide a way out of a debt spiral should it occur. To achieve this, an amendment will also be required allowing the users of third tier credit SFCs to bring proceedings on their own accord, rather than relying on the Commerce Commission to bring the proceedings. Through this approach, an incentive will be created for the payday lender to willingly price their PL SFCs more fairly due to the risk of their concluded contracts being reopened, causing them financial loss. Through this approach the risk of payday lenders immediately leaving the market or refusing to extend credit to PBs, which would leave the PB completely excluded from all forms of credit, is not exacerbated. It is submitted that in making this amendment to the unfair terms provisions of the Fair Trading Amendment Act 2013, it will not undermine the principles and purposes of the provisions, nor will it contradict the justifications for the exemptions to challenges of unfairness under the provisions.

The methodology of this paper will be to draw on case law, journal articles and commentary from New Zealand and overseas jurisdictions regarding consumer credit protection laws and SFCs. Empirical evidence from studies and surveys conducted in New Zealand and overseas will be used to investigate the third tier credit and payday lending industry and the typical PB. Studies and surveys in the field of consumer behaviour and behavioural economics will also be analysed to understand consumer vulnerability, how that vulnerability can be aggravated, and how it can be mitigated.

The parameters of this paper will be to only analysis the potential hardships to the PB caused by the total price of the PL SFCs and the use of the WG term. This thesis acknowledges in light of the Commerce Commissions findings in their recent investigations of the telecommunication, energy and gym industries, that there are many other possible terms currently being used in PL SFCs which may also cause substantial hardship to the PB, however those potential issues and terms are outside the scope of this thesis. This thesis also acknowledges that increasing protection to PBs and other financially excluded borrowers does not solve the real problem, but merely alleviates some hardship until the real problem can be solved. The real problem is poverty and a lack of alternative credit options for the PB. To solve the real problem the PB requires a more affordable alternative to PL SFCs, however it is also outside the scope of this paper to suggest alternative credit options.

# SECTION ONE

## **2. Contract Law Prior to Legislative Consumer Protection**

Deals are made every day. They are a necessity for living in a society where the individuals are not completely self-sufficient, but instead are reliant on others on a daily basis for their wants and needs. Where individual needs are, to an extent, objective and finite, wants will diverse significantly and increase exponentially. The subjective and infinite nature of wants reflect the uniqueness of the individual, both in terms of preference and circumstance. Due to this uniqueness, often it is only the individual themselves who can determine which deal is in their best interests. For this reason, an individual's freedom and ability to enter deals of their choosing is crucial to society's functionality<sup>2</sup> and the individual's highly valued autonomy.<sup>3</sup>

However, for a deal to be in the best interests of both parties, the deal must also be fair. In the absence of a third party decisions-maker determining the fairness within the deal, the parties themselves must be the judge of this. Where that deal involves entering a contract, in the absence of legislation acting as a third party decision-maker within the contract, the fairness of the contract will also be determined by the parties themselves. Over the last few decades an increasing multitude of consumer goods and services, from luxuries to essentials, have become only attainable through entering a contract. Therefore, in the absence of legislative contract protection, in today's society individuals must have the ability to adequately protect themselves from unfair contracts. For certain individuals in certain circumstances this can be effectively achieved. In other circumstances where there is a large power imbalance between a consumer

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<sup>2</sup> R Bigwood, *Exploitative Contracts* (Oxford University Press, New York, 2003).

<sup>3</sup> J Paterson 'The Australian Unfair Contract terms Law: The Rise of Substantive Unfairness as a Ground for Review of Standard Form Consumer Contracts' (2009) 33 *Melbourne University Law Review* 934, at 938.

and a business or supplier, concerns can arise over whether the consumer, or weaker party to the deal, is receiving a fair deal. One system of contract law which addresses the concern of potential unfairness within contracts while also promoting functionality and autonomy is a system of contract law called. CCT. Prior to legislative consumer protection in contract law CCT was applied in New Zealand.<sup>4</sup>

## **A. Classic Contract Theory**

The system of CCT is a libertarian philosophy which is based broadly on two hidden assumptions. The first, is that the individual knows what they want and is best placed in choosing the process of attaining it. The second, is that the more straight-forward and certain an agreement, the more beneficial it will be for both parties. Essentially, these assumptions presume first, that the individual can take care of themselves and second, the easiest way of making a deal will lead to the best deal. In regards to the first assumption, CCT assumes that promoting and upholding individual autonomy is sufficient to regulate economic markets and provides sufficient protection to consumers. This is premised in human self-interest, where people will ultimately act in such a manner that promotes their own individual interests.<sup>5</sup> This assumes that when an individual enters a contract, they will only agree to favourable terms and a fair price.

Although the individual consumer may be seen as the “little man” when beside the “big concern”, neo-classical economists<sup>6</sup> do not recognise this risk of market disruption from the power disparity as a concern. Instead, neo-classical economists consider that when the individuals collectively have similar interests, these collective interest dictate the market to which the supplier must conform.<sup>7</sup> In practical terms, this means that the supplier must provide

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<sup>4</sup> See R Epstein, ‘The Neoclassical Economics of Consumer Contracts’ (2007-2008) 92 *Minnesota Law Review* 803.

<sup>5</sup> R Posner, *Economic Analysis of Law* (9<sup>th</sup> ed, Aspen Publishers, New York, 2014).

<sup>6</sup> Neoclassical economics is an approach to economics focusing on the determination of goods, outputs, and income distributions in markets through supply and demand. This determination is often mediated through a hypothesized maximization of utility by income-constrained individuals and of profits by firms facing production costs and employing available information and factors of production, in accordance with rational choice theory. See Antonietta Campus (1987), “marginal economics”, *The New Palgrave: A Dictionary of Economics*, v. 3, p. 323.

<sup>7</sup> Epstein, above at n 4.

their goods and services at a quality, price and with contractual terms which consumers collectively are willing to accept.

In a free market, where consumers have multiple choices for similar goods and services, only those suppliers which are able and willing to provide the best goods and services with the best terms and price will survive.<sup>8</sup> Should a supplier insist upon a particular term to protect a legitimate interest which could not be protected in another way, in effect rendering the term unnegotiable, it is assumed that the consumer will examine the term. If the consumer then recognises this term in the contract to be unfavourable due to the risk of it being weighed against their particular interests, they will seek to be compensated for this risk by negotiating for a discount in the price paid under the contract.<sup>9</sup> Due to this system of ‘only the best survive’, CCT assumes there is no need for further protection to the consumer through legislative protection. Instead we can all sit back and let the free market do its magic, without the power imbalance that the supplier has over the individual consumer leading to an unfair advantage.<sup>10</sup>

In regards to the second assumption, CCT assumes that from building on the first assumption that the individual knows what they want and how best to get it, the easiest, or most functional and efficient way of obtaining it, is through a system of contract where there is certainty in the obligations and expectations between the parties. Where an entire agreement is fully contained within a contract, it would then be fair to assume that everything within the contract ought to be binding and nothing outside the contract ought to alter the agreement. By this, complete certainty of obligations and expectations by both parties can be achieved. Essentially, this means that what you see is what you get, and there will not be any surprises so long as both parties have duly taken the time and effort to read and understand the agreement. Since both parties will have an equal and fair opportunity to understand exactly what the agreement comprises of, both parties will have a fair and equal opportunity to attain what it is they want from the agreement. Should expectations of either party not become fully satisfied, the certainty

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<sup>8</sup> J J White, ‘The Usury Trompe L’Oeil’ (2000) 51 *South Carolina Law Review* 445.

<sup>9</sup> M J Trebilcock, ‘The Doctrine of Inequality of bargaining Power: Post-Benthamite Economics in the House of Lords’ (1976) 26 *University of Toronto Law Journal* 359, at 376.

<sup>10</sup> D Prigden ‘Putting Some Teeth in TILA: From Disclosure to Substantive Regulation in the Mortgage Reform and Anti-Predatory Money Lending Act of 2010’ (2012) 24(4) *Loyola Consumer Law review* 615 at 615



in having the whole agreement contained within the contract means that resolving disputes will be fair, effective and efficient.

There are two key practical advantages to *both* consumers and suppliers in using a system of contract law like CCT. The first practical advantage, which is credited to the promotion of autonomy, is that under CCT the risk of a third party decision-maker creating obstacles which interfere with “rationally maximizing subjective expected utility”<sup>11</sup> are removed.<sup>12</sup> Under CCT, the parties to the contract have complete freedom to decide its contents, so it is the parties themselves who decide what is fair based on what is best for them both. In contrast to this, where a third party decision-maker ultimately decides the concept of fairness through legislation or interpreting legislation, rather than the parties themselves, what they decide to be *fair* may not be *best* for either party.

In imposing an objective and universal concept of fair, as opposed to allowing the parties to decide their own subjective concept of fair, a risk is created that legislative restrictions might unwittingly decrease overall consumer welfare.<sup>13</sup> If a business relies on certain terms which are regarded as objectively unfair by legislation, then the business will need to find a way to operate without the term. Suppliers might compensate for restrictions on specific terms by introducing other disadvantages to the consumer, either by introducing objectively fair but subjectively onerous terms, a substantial price increase, or an exclusion of some goods and services to some consumers altogether. It is likely that many consumers would have preferred a perceived objectively "unfair" term which did not cause any real subjective disadvantage to them than a less "unfair" term where the price payable under the contract is at a much higher price or has terms which make the contract overall unattractive or unattainable.<sup>14</sup>

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<sup>11</sup> M A Eisenberg, 'The limits of Cognition and the Limits of Contract' (1995) 47 *Stanford Law Review* 211

<sup>12</sup> M J Rizzo and D G Whitman, 'The Knowledge Problem of New Paternalism' (2009) *Brigham Young University Law Review* 905, at 909.

<sup>13</sup> R J Mann, 'After the Great Recession: Regulating Financial Services for Low and Middle Income Communities' (2012) 69 *Washington and Lee Law Review* 729, at 746.

<sup>14</sup> K Tokeley, 'It's for your own good: Legal paternalism and New Zealand consumer credit laws' in K Fairweather, P O'Shea and R Grantham (ed) *Credit, Consumers and the Law: After the global storm* (Routledge, London, 2016) 19, at 27.

The second key practical advantage with CCT, which is credited to the promotion of functionality, or specifically certainty in contract, is that the overall costs of providing goods and services can be reduced. Under CCT, there is no risk that a concluded contract will be reopened or altered because of the contract's contents. This means that the parties to the contract can fully rely on its contents being binding. In contrast to this, where legislation allows the ability of a third-party decision-maker to reopen or alter a concluded contract due to its contents not adhering to an imposed definition of fair, neither party can rely or be certain that what is contained within the contract will eventuate. This uncertainty is particularly burdensome to businesses, which rely heavily on the certainty of the terms within their concluded contracts.

It could be argued that businesses could minimise this burden of uncertainty by simply drafting objectively fairer SFCs, however this can be somewhat of a difficult task, even when best efforts are made to adhere to "fair" standards. This is due to the notion of "fairness" being inevitably subjective, rendering it extremely difficult to adequately define the concept as an objective standard.<sup>15</sup> Since even the provision drafters struggle to clearly define a universal concept of "fair", it will in turn be extremely difficult for businesses to draft contracts that will adhere to and achieve the correct and certain standard of "fair". This uncertainty then is largely unavoidable. If businesses are to work inside these restraints of uncertainty, this will convert to financial risk to the businesses, which will need to be calculated and incorporated into the cost of the goods and services they provide. This then becomes a disadvantage to the consumer when they are required to absorb the supplier's risk from an increased price on the product or service. Conversely, relying on the certainty of CCT the risk is significantly reduced, allowing increased efficiency, correlating to reduced business costs and presumably a reduced overall price of goods and services to consumers.

In certain situations, largely accredited to the advantages identified above, CCT can provide an effective means for both suppliers and consumers to achieve the deal best suited to them. One such situation was when I purchased a present for my son. A few weeks before my son's 7th birthday, while out shopping together, my son saw a bicycle he liked. Out of all the bicycles

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<sup>15</sup> E Glaeser, 'Paternalism and Psychology' (2006) 73 *University of Chicago Law Review* 133, at 138.

available for purchase, he only wanted *this* particular bicycle. Since *this* bicycle was well within my budget, I promised him I would buy it for him for his birthday. A few days before his birthday I went back to the shop to buy the bicycle. I knew the cost of *this* bicycle was \$300, but the price was not the most important factor for me. Instead, the factors which were important were purchasing *this* particular model of bicycle, *in time* for my son's birthday. The problem I had was that *this* particular bicycle had sold out. I had delayed too long in purchasing it and now the opportunity to purchase *this* bicycle, *in time*, had gone.

After some discussion with the salesperson I was able to evaluate my options. First, I could buy a different bicycle. I did not like this option because getting the right bicycle was important to me. Second, I could get the bicycle I wanted, but it would not be within the time frame I wanted. This option I also did not like, as getting the bicycle in time was also important. Third, I could travel out of town to pick it up from the warehouse where they were being stored. This option I did not like much either. This would cost me almost the same in travel costs as the cost of the bicycle, not to mention the time it would take. Lastly, I was given another option after some negotiation. I was able to get *this* bicycle, *in time*, if I was prepared to pay an additional \$150 to get it couriered in from the warehouse where they were being stored. Even though I would be paying 50% more for the item than it was worth, I happily agreed to make that deal.

For my preference and situation, the price under this contract was well worth what I would get in return, being the satisfaction of doing what I had said I would and not feeling the guilt of disappointing someone I loved. These were the important factors to me, and only known to me. After I had fulfilled my part of the contract in paying the purchase price, I was able to rest easy on the certainty that I would receive *this* particular bicycle, *in time*. What I had relied upon eventuated. I was happy, my son was happy and presumably the supplier of the bicycle was happy. In my case, spending \$150 to buy my way out of a deeply regrettable mistake *was* the right choice for me. I was able to satisfy both my important factors and at a price fair less than it would have otherwise cost. In other words, I got what I wanted, and this was only possible due to the freedom I had to enter the deal of my choosing. However, there may be situations and circumstances where the deal made will not be the *right deal* for one party to a contract,

despite that party having self-interest and being privy to the individualistic wants and needs only they fully know.<sup>16</sup>

It is submitted that there is a distinction between entering the wrong deal to simply exercising poor judgement resulting in a bad decision. Often people will make choices that are arguably poor and decrease their own welfare. There are many reasons consumers make poor decisions. Sometimes the poor decisions are solely due to poor judgement. One example of this is smoking. It is generally accepted, due to the extensive warnings through media and advertising, that smoking over time causes many potentially lethal diseases. Objectively speaker, to engage freely and consciously in the activity of smoking in spite of this would be a poor decision.<sup>17</sup> Despite this however, many consumers choose to engage in this activity regardless.

The reason for some consumer choosing to consciously make poor decisions may be because of a lack of thought to the long term effects compared to the short term gain. Another reason could be that thought was in fact given, and the short term gain to the particular individual was worth the long term risk.<sup>18</sup> In either case, at the time of making the decision, the consumer was making the right deal for them. This is because regardless of whether or not the deal made was ultimately a wise decision, when the consumer made the deal the consumer received exactly what they wanted and expected from the deal. In contrast to this however, it is when the consumer does not receive what they wanted or expected from the deal that the deal made will be the wrong deal.

Consumers will often make the wrong deal, and the reason for this is always because the consumer makes a mistake of some kind and some degree. The inability to completely eliminate human error means consumers will always make mistakes.<sup>19</sup> Sometimes mistakes

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<sup>16</sup> K Tokeley "Consumer Law and Paternalism: A Framework for Policy Decision-Making" in S Frankel and D Ryder (ed), *Recalibrating Behaviour: Smarter Regulation in a Global World* (LexisNexis, Wellington, 2013) 265, at 280.

<sup>17</sup> Other examples include making unhealthy decisions in regards to diet and lack of exercise, using sunbeds, consuming large amounts of alcohol, engaging in unprotected sex, engaging in dangerous leisure activities and taking out high interest short term loans for non-essentials.

<sup>18</sup> Tokeley, above n 16, at 282.

<sup>19</sup> Richard A Epstein, a neo-classicalist economist, has conceded that people do often make mistakes and exercise poor judgment: He states "...it seems impossible to deny two facts about human nature. First, people often make

may be made due to unfavourable circumstances. If I was to mistakenly purchase the wrong model of bicycle for my son due to rushing to meet my deadline, then that mistake would be my own and I could not reasonably expect the supplier to absorb the consequences of my mistake. It is fair to assume an expectation is placed upon a consumer to take care while making purchases and ensure they choose correctly, despite unfavourable personal circumstances.

Protecting consumers from their mistakes and guaranteeing an optimal bargain each and every time they enter a contract is not possible to achieve, and some mistakes the consumer ought to bear. CCT extends this to include mistakes made by entering the wrong contract where some of the terms agreed to within the contract cause the contract to not be overall beneficial to the consumer.<sup>20</sup> The rationale is that for individuals to have the right to contract, they must accept the responsibility of any mistakes made within the contract. Provided that the parties entered the contract freely, acted rationally in pursuing their subjective interests and had freedom to negotiate the terms, as CCT assumes, then all the terms would rightly be binding.<sup>21</sup> Due to this rationale, traditionally contract law has endeavoured to provide predictability and clarity by refusing to allow people to escape from their contracts simply because they were foolish enough to enter into a bad bargain.<sup>22</sup> Although it must be accepted that bad bargains do occur within the marketplace, and will likely always occur, in some situations and circumstances these bad bargains may not only be the wrong deal for the consumer, but they might also be unfair.

It has been found that consumers will often make unfair deals for themselves by freely and willingly entering unfair contracts. Similar to simply making the wrong choice, entering an unfair contract also begins with a mistake on the part of the consumer. However, in this case the mistake made may not be solely due to the fault of the consumer or unfavourable circumstances. Instead, the other party may also be at some fault. When a consumer contracts with a party which receives a financial advantage in their mistakes, which may often be the

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serious mistakes in deciding important matters. Second, people often find it hardest to keep their emotions in check when it matters the most," Epstein, above n 4.

<sup>20</sup> The common law remedy of Rectification of contract can be used to overcome a mistake made by both parties. In addition to this The Disputes Tribunals also have their own powers to deal with contracts and vary terms.

<sup>21</sup> *Printing and Numerical Registering Co v Sampson* (1875) LR 19 EQ462, at 465.

<sup>22</sup> Eisenberg, above n 11, at 212. Eisenberg describes this as the 'bargain principle'.

case where the other party to the contract is a supplier or business, there is an incentive for the supplier to not assist the consumer by illuminating their mistakes. This may sometimes lead to a degree of unfairness, but it cannot be expected that all stronger parties will, out of moral fortitude, ensure the weaker party receives an optimum bargain. Case law has stated that economic deals may be inherently unfair, and in commerce it is natural for suppliers to pursue a degree of selfishness in their contracts.<sup>23</sup> However, where the stronger party to a contract, like a supplier or business, goes further to deliberately facilitate consumer mistakes, this disadvantage can result in an unfair deal which ought to merit intervention.

To demonstrate how a contract may develop into an unfair deal due to a supplier facilitating a consumer mistake, I will return to the example of purchasing a bicycle for my son. In my situation, I had placed myself at a disadvantage in desperately wanted a particular type of bicycle which could no longer be purchased at the regular retail price within the time frame I wanted. I was aware of my disadvantage, and this was the reason why I was willing to pay well over the market price to get it in time. However, in making that deal I was trusting that the price I was paying over the retail price was fair in relation to the trouble that the supplier would have to go to in order to get me the bicycle. If the supplier was in fact able to get the bicycle for a nominal amount and for relatively little trouble, then paying an additional \$150 would be unfair, even though I had willingly agreed to it and was getting what I wanted from the contract. In this case paying the extra \$150 would be a mistake facilitated by the supplier in allowing me to believe that the only way to get the bicycle in time was to make the mistake, which the supplier would then gain an unfair financial advantage from. This unfairness derives from unfairness within the contracting process, known in contractual legal terms as procedural unfairness. Strict CCT does not provide relief for procedural unfairness, however many jurisdictions including New Zealand provide some recourse to the consumer in such unfair circumstances.

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<sup>23</sup> In *Biotechnology Australia Pty Ltd v Pace* (1988) 15 NSWLR 130, Kirby P explained at 132-133:

“the law of contract which underpins the economy, does not, even today, operate uniformly upon a principle of fairness. It is the essence of entrepreneurship that parties will sometimes act with selfishness. That motivation may or may not produce fairness to the other party. The law may legitimately insist upon honesty of dealings. However, I doubt that, statute or special cases apart, it does or should enforce a regime of fairness upon the multitude of economic transactions governed by the law of contract.”

## **B. Common Law Protection from Procedural Unfairness**

In qualifying instances where the process of forming the contract is found to be unfair, it is possible for the courts to use common law remedies and equitable doctrines to re-open contracts and challenge the fairness of the contract formation.<sup>24</sup> Where procedural unfairness is found, a court may set aside or alter an otherwise validly formed contract on the grounds that due to the consumer's situation and the supplier's actions at the time of the decision, the consumer's ability to accurately access their options and the effects of the decision were impaired. In such a case, it can be derived that true consent was not freely given.<sup>25</sup>

It is not controversial or novel to insist upon procedural fairness in contract law, or for the Courts to intervene where there is breaches of procedural unfairness.<sup>26</sup> One of the functions under the law of contract generally is to preserve the integrity of the bargaining process and the conditions for substantially unconstrained and informed decisions by contracting parties.<sup>27</sup> This objective is promoted by such doctrines as fraud, misrepresentation, duress, undue influence<sup>28</sup>, unconscionable<sup>29</sup>, misleading or deceptive conduct, and the use of the contra-proferentem rule<sup>30</sup>. Although equitable doctrines do provide some protection to a vulnerably weaker party to a contract, these doctrines do not go so far as to protect all consumers from all unfairness in the contracts they enter. Equitable doctrines can only provide recourse where it was exclusively the process of forming the contract which was unfair,<sup>31</sup> or the circumstances relating to the forming of the contract.

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<sup>24</sup> P Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford University Press, New York, 1979)

<sup>25</sup> A Robertson, 'The limits of Voluntariness in Contract' (2005) 29 *Melbourne University law Review* 179, at 181.

<sup>26</sup> Paterson, above n 3, at 938.

<sup>27</sup> S A Smith, *Contract Theory* (Oxford University Press, Oxford, 2004), at 354.

<sup>28</sup> The equitable doctrine of undue influence and the common law doctrine of duress were developed in order to provide relief where a party did not freely give consent to the contract. This notion of a freely given consent is also present in the common law rule that requires a party to give explicit notice of particularly onerous terms. See, for example, *Thornton v Shoe Lane parking Ltd* [1971] 2 QB 163

<sup>29</sup> An argument of unconscionability may be used in that the terms had not been properly incorporated into a contract as the consumer did not fairly have an opportunity to see those terms prior to the contract's formation. In such instances, the terms are unenforceable due to defects in procedure, rather than the unfairness of the terms themselves.

<sup>30</sup> The contra proferentem rule allows a court to construe ambiguity in a contract against the party seeking to rely on it. This can only be used if a term is ambiguous and then only for certain terms.

<sup>31</sup> Even where procedural unfairness is established, many equitable doctrines are difficult to access as a remedy due to their narrowness. Unconscionability for example first requires the weaker party to establish a qualifying

To demonstrate the practical short-fall of procedural protection, I will alter the facts of my situation from purchasing a bicycle for my son, to requiring a short term loan urgently to pay for his essential needs. Similar to the contract to purchase the bicycle, in this case my situation at the time of entering the contract is also not ideal. In this situation, due to my credit rating, I am “financially excluded”<sup>32</sup> from first and second tier lenders. This will mean that in order to secure a loan, I will need to borrow from a third tier lender. This will require me to pay more interest on the loan, and essentially more for the product than I would need to with a first or second tier lender.

In the previous case of the bicycle, I also was required to pay more for the product than it would normally cost, and similar again to that case, the price payable under the contract is not the most important factor for me. Where before the most important factors were purchasing *this* bicycle, *in time*, in this situation it is borrowing *this* amount of money, *in time*. Since essential needs can be converted to a specific monetary value, it is for at least *this* specific value I need to attain from the lender. My son’s essential needs cannot be discounted, so I cannot discount the amount I need to borrow. I also need to enter the contract immediately, since these needs cannot be postponed. In this case then *in time*, means *now*. Therefore, the most important factors for me in entering this credit contract are *how much* and *when*, and not the total price that the loan will eventually cost me. Whether or not this deal will be ultimately beneficial and

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disability at the time of forming of the contract, second that the stronger party had knowledge of the disability, third that they acted on that knowledge to taken advantage of the disability to gain a benefit and finally that the weaker party suffered a sufficient degree of detriment from the actions of the stronger party. Where all these requirements cannot be sufficiently proven by the weaker party, a remedy under unconscionability will fail. The second difficulty with equitable doctrines is the uncertainty of whether the standards are likely met within the particular contract. Unfairness is inherently subjective, so there is a much vagueness as to the standard of what is required. This lack of objective standards and larger policy considerations has the inevitable effect of the weaker party defending a considerably larger evidential onus than the stronger, which equates to more time and effort on the part of the weaker party. When this is combined with the high cost of litigation, equitable doctrines as a remedy poses a significant risk, and with it a substantial disincentive for consumers to pursue. See generally P Chin ‘Payday Loans: The Case for Federal Legislation’ (2004) *University of Illinois Law review* 723.

<sup>32</sup> The definition of financial exclusion can be taken in broad sense to mean processes that prevent poor or disadvantaged social groups from gaining access to the financial system, or can be looked at in a more narrow sense as the absence of ownership of a particular type of financial product. Financial exclusion has been defined in Australia in ‘Ministry of Consumer Affairs *Third-tier Lender Desk-based Survey 2011*’ at 7 as “the lack of access by certain consumers to appropriate low cost, fair and safe financial products and services from mainstream providers”. Another definition is the lack of access for vulnerable consumers to affordable small loans, or exclusion from access to appropriate low cost, fair and safe small amount loans. In using such a definition it will follow that financially excluded consumers have reduced options in gaining credit and excluded from first and second tier lender.



fair to me, I will not know until the time comes for me to have to make the repayments. However, at the time of entering the contract, I will be satisfied purely if I can get the amount I need now. This hypothetical situation is similar to the beginning of a real life experience I had many years ago when entering a third tier credit contract which ultimately was not the right deal for me, or a fair deal.

### **3. The Justification in the Shift of Consumer Protection**

When I was a lot younger I wanted a new car. The car I wanted I could not afford, so I used a loan to pay for the majority of the car's purchase price. This required making weekly payments on the loan, which I was able to achieve despite my low and fixed income. Sometime later I crashed this car, which required a contribution of \$1350 from myself to cover the excess over my insurance policy on the car. Since I relied on the car for my transport, I saw it as essential to have the car fixed and usable again as soon as possible. I was not able to afford this required amount however, nor was I able to get a loan, overdraft or credit card from my bank. With my lack of options being apparent, I approached a finance company to lend me \$1000 of the required amount. Although these circumstances vary from my hypothetical example where the funds required are not directly related to essential needs, at the time of taking out the loan to fix my car I did perceive borrowing the funds as being essential.

The loan agreement I entered was a 32 page long SFC. Although I did glance at every page within the contract, I must confessed that it was a brief skim read at best and I did not fully understand most of what I read. Where I did not understanding the effect or even meaning of the terms, I did not ask any questions in relation to them, as I did not think it was something people did. I was aware that this would mean I was entering the contact ignorant to the majority of the terms contained within it, but I remember thinking it was not a big deal. I did however initially intend to read the contract, however due to becoming tired and confused by it, I must also confess that I gave up on it halfway through. I ultimately felt it was not necessary to read the entire contract since I had already made up my mind that I would agree to the SFC before

even being handed it. Therefore, I thought reading it would not make any difference. This was largely because I had been advised before being presented with the contract that I would get the cash advance I needed within 24 hours. Having the funds available within this time frame was the first “main thing” I examined.

Since I could only afford \$350 of the \$1350 needed to cover my insurance excess, the amount I needed to borrow was \$1000. \$1000 was the amount I had been assured would be advanced. This was the second “main thing” I examined in relation to the contract. Other terms that I did also examine, but not to the extent of the two “main things”, was the amount I would need to pay back and the time frame I had to do that. I was required to pay the loan back with the interest within 36 days. The interest would be at 507% per annum, correlating to be \$500 interest over the duration of the loan. To my understanding, this would mean the total amount payable would be \$1500 for the initial \$1000 borrowed.

A few weeks after entering the loan agreement I realised I would have trouble paying the money back by the due date. I had rushed into the loan, hoping to be able to pay it back, but in reflection I was not sure. With the high interest the loan incurred, in addition to the car loan repayments I was also committed to, it was evident within the first 2 weeks of receiving the loan that I was not in the position to make full payment on the loan within the 36 days. In addition to this, which I was unaware of at the time of entering the contract, was that there was an establishment fee of \$95 which was added to the total loan. Also, there was an administration fee of \$10. The total price payable was now in fact \$1605. Unable to pay the loan back, I missed the due date, hoping to be able to pay the loan back in full a few weeks later.

To my surprise, my lender then informed me by telephone that if I was unable to make immediate payment on the loan an authorisation would be lodged to garnish the debt I owed straight from my wages. It was at that point I realised that when signing the contract I had agreed to a term which allowed the lender to garnish my wages should I fail to make the necessary repayments in time. This led me to approach the lender to come to another arrangement, as I could not afford to have my wages garnished at that time or I would be in a worse situation than before I had gotten the loan.

After some discussion with the lender I reached an agreement for the lender to not garnish my wages, but to instead re-finance the loan so I would now make smaller repayments on the loan over another 36 day period. This would be available with an additional 185% default interest on the amount overdue, a \$70 default fee, a \$40 change of finance fee, a \$30 wage garnishment assignment fee, and a \$7 reminder letter. This would bring the total price payable under the contract to now be \$1752 on the initial loan of \$1000, not including the additional cost of the default interest on the overdue amount owing. It was at this point that I realised I had gotten financially overcommitted. I knew that there was a good chance I would be unable to make the smaller repayments either, and I was running the risk of entering a loan which I may never be able to pay back on my own. I then did the sensible thing in swallowing my pride and asking for help from family to settle the loan.

Had I not had the luxury of receiving help from family and not needing to accept the new loan agreement, it is likely that I would have needed to roll that new loan over as well, which would incur more fees and interest, continuing my cycle of debt, leading to a debt spiral which could potentially take years to get out of. It could be argued that this consequence of borrowing \$1000 meant the deal I made was not only the wrong deal for me, but an unfair one. It could also be argued however that this unfair deal was my own fault, due to not conducting my due diligence before agreeing to the loan and hence not acting in the way reasonably expected of an average adult consumer. However, it could be even further argued that I merely acted in a way that could be expected for someone in my position. This can be demonstrated by identifying that the deal was unfair to me because I mistakenly underestimated the cost of my \$1000 loan for two understandable reasons given my situation.

The first is that the bundling of the total cost of the loan meant I was not completely aware of how much I was required to pay back. Initially I was under the impression that I had to pay back \$1500, and it was only later that it came to my attention that it was actually more than that. This total amount payable on the loan was not fully examined by me. Although I did attempt to examine the cost of the loan, it was difficult to understand what the total cost would be with the many contingency fees that the price eventually consisted of. Also, the price of the

loan was not the most important factor, so this created a disincentive for me to invest the time needed to identifying the true cost that the loan could potentially be.

The second reason for underestimating the total cost of the loan was that I had not taken into account the WG term, which essentially assigned most of the lender's risk, which was recognised and largely compensated for in the high interest rate, back to me. This term was found towards the end of her SFC, after the point where I had stopped giving serious thought to the contents of the contract. Since this was the first time I had enter this type of agreement, I was unaware of what the term meant, or its effect. I entered the loan with the false assumption that should I not be able to make the payments, I could always negotiate a little more interest for a little more time. The WG term however meant I would have no leverage to negotiate. For my situation, the risk of not making the payments would be rolling over the loan, creating the risk of me no longer being the one-off customer I had intended to be, but instead a customer the lender could draw on for continuing business over several years.

Neither of these two factors however in me becoming a party to an objectively unfair contract were related to the process of forming the contract. Since there was no procedural misconduct on the part of the lender, the resultant objective unfairness could not be connected to an unfair process, so could not be defined as procedural unfairness. Instead, the objective unfairness was substantive unfairness from the unfairness inherent within the substance of the contract terms themselves. This meant that procedural protections under the common law and equity would not be available to me. Although the 507% per annum interest that I was required to pay under the loan may be argued to be inherently unfair or even unconscionable, courts in the US, the UK and Australia have been reluctant to invalidate contracts through the doctrine of unconscionability solely on the basis of unfair pricing without some proof of additional bargaining misconduct.<sup>33</sup>

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<sup>33</sup> *Kakavas v Crown Melbourne Limited & Ors* [2012] HCATrans 348 (14 December 2012) at [18]-[20]; See Chin, above n 31, at 747. Judicial reluctance to find interest rate prices unconscionable can also be attributed to the difficulty of determining what a fair price might be. It has been suggested that some factors to be considered are (1) the lender's costs in obtaining the money lent; (2) the lender's cost in making and administering the loan; (3) the risk of inflation; and (4) the risk of default. An unconscionability claim of unfair interest rate pricing may be defeated by proof of commercial realities that justify the high price. For payday lenders who traditionally serve high-risk borrowers, this proof is easy to produce. The doctrine of unconscionability will also be of no assistance here as one of the requirements, as stated, is that the weaker

It has been found that one of the most frequent and dangerous situations for consumers mistakenly entering substantively unfair contracts is when it comes to entering certain credit contracts. Research published in late 2008 showed that New Zealand consumers typically make poor choices relating to credit, particularly in regards to the amount of credit borrowed and the credit terms.<sup>34</sup> Also, with certain contracts, such as credit contracts like the type of contract I entered to repair my car, the consequences of those mistakes can be very costly, frequently leading to consumer chronic debt and hardship. It has been found that one of the most harmful and unfair types of credit contracts which consumers frequently enter are a type of third tier credit contracts known as PL SFCs.

There are three main problems with these particular credit contracts that make them potentially harmful and unfair, all related to the assumptions of CCT, being freedom to negotiate, rational consumer behaviour and equal bargaining power, being severely weakened when consumers enter these contracts.

The first problem is related to the inability of the consumer to effectively negotiate the deal. Due to only the lender creating the contract, these types of credit contracts will usually benefit the party presenting it to a much greater degree than the party receiving it. Although consumers willingly enter these deals knowing they did not negotiate them, they still enter them with the expectation that they are being represented in the deal and the deal will bring them a fair or equal degree of benefit. Yet, with these types of contracts there will seldom be equally shared benefits, and often the added benefit granted to the party who created it will be at the expense of the party receiving it. The first problem then is that the consumer enters the contract with an

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party must suffer from a qualifying disability. Although, as it has been also stated, I was in a desperate situation with little bargaining power at the time of entering the contract, as stated in *CBA v Amadio* (1983) 151 CLR 447, at 462 per Mason J, simply being a desperate consumer with less bargaining power than a stronger party is not considered a special disadvantage, and will not satisfy the narrow criteria of unconscionability. See also A E Farnsworth, *Farnsworth on Contracts* (2<sup>nd</sup> ed, Aspen Publishers, New York, 1998), at 324.

<sup>34</sup> Jaimie Legge and Anne Heynes, *Beyond Reasonable Debt Part 1: A Background & part on the Indebtedness of New Zealand Families* (Research Report 8/08, Families Commission and Retirement Commission 2008) [www.familiescommission.org.nz/web/beyond-reasonable-debt/part-one.html](http://www.familiescommission.org.nz/web/beyond-reasonable-debt/part-one.html); New Zealand Ministry of Consumer Affairs, *Review of the Operation of the Credit Contracts and Consumer Finance Act 2003* (Discussion Paper, September 2009) [www.consumeraffairs.govt.nz/legislation-policy/policy-reports--and-papers/discussion-papers/review-of-the-operation-of-the-credit-contracts-and-consumerfinance-act-2003](http://www.consumeraffairs.govt.nz/legislation-policy/policy-reports--and-papers/discussion-papers/review-of-the-operation-of-the-credit-contracts-and-consumerfinance-act-2003).

unrealistic expectation that they are being considered in the deal, and this causes them to enter the contract under-represented.

The second problem is related to the inability of the consumer to act rationally. When a party enters a contract with an expected benefit, they ought to thoroughly and carefully examine it to ensure they are receiving that expected benefit. With these types of credit contracts, they are extremely difficult to effectively analysis and decipher. This then requires added effort from the consumer to ensure they receive their expected benefit. However, the consumer instead reduces effort, due to consumer rational thinking being severely diminished during the contraction process of these contracts. If the consumer is not represented sufficiently in the contract, the consumer will be unlikely to discover it. The second problem then is that the consumer is unable to adequately protect themselves from the risk of objective unfairness, and this causes them to enter the contracts unprotected.

The third problem is related to the inability for the consumer to achieve equal bargaining power. Where one party is particularly weak, vulnerable, or heavily reliant on the other party, there is a large risk of the weaker party being pressured into reluctantly agreeing to terms which they do not like. Even if the consumer was then able to discover they had been under-represented within the contract, they would unlikely be in a position to alter the contract. The third problem then is that the consumer is unable to restrict the other part's benefits from the contract, and this causes them to enter the contract under-valued. To demonstrate these three problems each will be addressed individually.

### **A. The Non-Negotiable Deal**

As has been stated, the contract I was presented with when obtaining the loan to fix my car was a SFC from a third tier lender, very similar in many respects to a PL SFC. When entering this contract, I had the expectation that I would receive some money now to get my car fixed and have the benefit of being able to carry on with my life prior to crashing my car. In addition to this, I entered the contract with the expectation that I would repay the amount of money I had

borrowed, plus a fair amount of interest. There are two factors which are significant in considering my probability of receiving my expected benefit.

The first factor is that I contracted through a SFC. The second is that I contracted with a third tier lender, similar to a payday lender. The first factor of the contract being a SFC relates to my lack of opportunity to negotiate a contract which would optimise what I wanted to achieve from the deal. The second factor relates to a lack of opportunity to restrict within the contract what the party I was contracting with wanted to achieve from the deal. Each of these two factors will be addressed individually. To understanding the PL SFC it is useful to begin by first addressing the concept of the SFC.

### **(i) The Standard Form Contract**

Typically a SFC is a contract which has been previously prepared by a stronger party, or the supplier of a good or service within the contract. The purpose of a SFC is for standard use for all consumers contracting to purchase a particular good or service. The use of SFCs is not only beneficial to both consumers and suppliers,<sup>35</sup> but they are a necessity.<sup>36</sup> Without SFCs businesses and suppliers would need to construct an individual contract with every consumer or business that they supplied to or do business with. Not only would this be an impossible process, but the cost of doing so would generate large administrative costs which would likely place the cost of the actual product or service out of reach for most consumers. This is because SFCs generate efficiencies for suppliers by standardising contractual risk and streamlining the internal administration processes.<sup>37</sup> It is this standardisation of risk which allows affordability in the price of the product as it allows the supplier to create and maintain stable supply costs. In addition to reduced price, the efficiencies generated by SFCs also provide greater supply

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<sup>35</sup> M J Trebilcock, 'Rethinking Consumer Protection Policy' in Charles E F Rickett and Thomas G W Telfer (eds), *International Perspectives on Consumers' Access to Justice* (Cambridge University Press, Cambridge, 2003) 68, at 93.

<sup>36</sup> Noting the efficiencies of SFCs, Rick Bigwood suggests that SFCs must be 'endured as beneficial and necessary in complex free market economies'. See Bigwood, *Exploitative Contracts*, above n 2, at 274.

<sup>37</sup> Legal advice is obtained in relation to only one standard contract which is promulgated throughout an enterprise for uniform use, enabling any member of staff to deal directly with the consumer. See P Santucci, 'Substantive Fairness in Australian Standard Form Consumer Contracts: Lessons from the UK the Experience' (2011) 2 *Oxford University Commonwealth Law Journal* 171, at 173.

and variety for consumers, making it possible to administer business deals as a matter of routine.<sup>38</sup> Hence, SFCs are in effect a valuable and efficient risk management device, providing a calculated and factored contingency should anything go wrong with the expectations of either party to the contract.

Although SFCs have benefits in reducing costs, they will not take into account the specific characteristics of the other party and usually allow little to no negotiation over, or variation of, the terms of the contract.<sup>39</sup> They are strictly presented on a '[t]ake it or leave it'<sup>40</sup> basis, which does not fit well with the assumption made by CCT that consumers, in exercising their complete freedom of contract over the goods and services they contract for, will effectively negotiate the terms they agree to.<sup>41</sup> If SFCs however were subject to negotiation like the classical contract, then all the benefits that arise from them would be redundant. Costs to suppliers, and then to consumers, are able to be reduced precisely because of the elimination of the negotiation costs. However, these advantages gained by SFCs are not equally shared between the parties, leading to the party creating it to be overly, and in some cases, unfairly advantaged.

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<sup>38</sup>Karl Llewellyn observed that, 'standardizing contracts is in this a counterpart of standardizing goods and production processes'. See K Llewellyn, 'Book Review: *The Standardization of Commercial contracts in English and Continental Law*' (1939) 52 *Harvard Law Review* 700, at 701; Santucci further submits that the need for standardisation is further increased by the expansion of electronic transactions where standard contract terms enable suppliers to make uniform offerings to vast numbers of consumers who often reside in different jurisdictions. See Santucci, above n 37, at 173.

<sup>39</sup> This lack of opportunity to negotiate creates an inability for the consumer to influence the terms of standard form contracts has prompted Friedrich Kessler to describe these contracts as "contracts of adhesion". See F Kessler, 'Contracts of Adhesion- Some Thoughts about Freedom of Contract' (1943) 43 *Columbia Law Review* 629; The New Zealand Law Commission has also observed that the very nature of the terms drawn up beforehand by a strong party, are 'a long way from the assumptions that seem to underlie freedom of contract. They are more akin to private legislation than to the traditional contract. See New Zealand Law Commission, "'Unfair" Contracts: a Discussion Paper' (Preliminary paper No 11, 1990)

<sup>40</sup> Standard form contracts were described by Lord Diplock in *A Schroeder Music Publishing Co Ltd v Macaulay* [1974] 3 All ER 616, at 624 as: "The terms of this kind of standard form of contract have not been the subject of negotiation between the parties to it, or approved by any organisation representing the interests of the weaker party. They have been dictated by that party whose bargaining power, either exercised alone or in conjunction with others providing similar goods or services, enables him to say: 'If you want these goods or services at all, these are the only terms on which they are obtainable. Take it or leave it.'"

<sup>41</sup>It has been submitted that this "take it or leave it" basis does not tend to promote the principle of freedom of contract or appear to offer any potential for genuine consent on the part of the consumer. See Paterson, above n 3, at 940. See also *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd*, above n 2, at 302. See also A Robertson, 'The Limits of Voluntariness in Contract' (2005) 29 *Melbourne University Law review* 179, at 180.



## **(ii) The Unfair Advantage**

The party which presents the SFC will always have at least some advantage. This is because the party which presents it and creates it denies all input from the other party. The advantage to the party which creates and supplies the SFC then arise from both knowledge and freedom.

In regards to the advantage of knowledge, if the supplier pre-prepares the contract, then it can be assumed that the supplier is fully aware of the contents. Although the contract may be lengthy, every term included in the contract will have been analysed and included for a particular reason. The meaning and effect of the terms will have also been thoroughly understood and examined by the experts that drafted them. Conversely, the other parties using the SFC, especially if they are a general consumer, will have very limited knowledge as to how the particular terms will operate, or be privy to their full effect. In order for the parties to acquire equal grounds in regards to knowledge of the contract, the party receiving the SFC will need to first thoroughly read the SFC. Second they will need to understand it. This then places a heavy burden upon the party receiving it if they are a general consumer, as that party will not have the same experts to assist them as the party which created it had. The result of this is that the party which receives the SFC will likely remain disadvantaged as far as knowledge, and unable to fully understand the risks of all potential detriment from the entering the contract.

An example of this disadvantage within the context of PL SFCs is the total potential cost of a loan. Where the cost of a loan is dependent upon contingencies, the potential cost will never be a fixed amount, and so difficult to decipher. With the consumer receiving the SFC not being unable to fully understand the effect which all the contingencies have on the potential price under the contract, it is submitted that the borrower will not fully understand or know the potential price of the loan which they receive from the lender.

In regards to the advantage of freedom, the supplier, with its vast resources, will have likely collaborated with expert consultants and legal experts to create a contract which is of optimum benefit for its own business purposes. It is likely that little to no concern will have been given

to any other potential party using the SFC to contract with them. The party which presents the SFC are aware they have almost complete freedom to decide what terms are to be included, how those terms will operate, and how the terms will be balanced amongst other terms. With the lack of resistance from the other party there will be an incentive for the party creating the contract to be somewhat selfish in the conditions of supplying the product to the other party. This selfishness can then become detriment to the party receiving it. An example of this within the context of PL SFCs is the evidence that commercially powerful businesses, as well as lenders, frequently capitalise on their freedom advantage by shielding against some commercial risks by contracting those risks out to the consumer.<sup>42</sup> It is submitted that such an example used by lenders is the WG term, which almost all PL SFCs now use.

With the party receiving the SFC being disadvantaged by not being able to advance their interests within the contract or restrict the interests of the other they are left severely vulnerable to detriment. With this vulnerability to detriment created by SFC use, CCT assumes there will be a response in increased consumer self-protection. However, the use of SFCs offers no increase in protection. Such a situation on its own presents a strong justification for preventing traders from exploiting their position to rely upon onerous, objectively unfair terms. With the risk of potential detriment identified within the non-negotiable PL SFCs, this analysis now turns to the second problem with these types of credit contracts, being the difficulty for consumers to adequately understand them so to effectively protect themselves.

## **B. The Irrational Consumer**

As has been established, PL SFCs have potential to cause consumer detriment where all the terms within the non-negotiated PL SFC are agreed to. The second problem with these types of credit contracts is that consumers are likely to often mistakenly agree to these terms which will lead to the potential detriment. In many instances, these mistakes will be unavoidable. The

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<sup>42</sup> B Billson (Minister for Small Business), Address to the Australian Food Grocery Council Industry Leaders Forum, speech, Canberra 30 October 2013; Treasury Legislation Amendment (Small Business and Unfair Contract terms) Bill, Explanatory Memorandum, 7.

term unavoidable however is problematic. Anything and everything can technically be avoided. CCT assumes *all* mistakes are avoidable. CCT makes this assumption because it assumes that consumers will always act in a certain way when they enter a contract, being rational, and through that pursue avoidance of detrimental mistakes. Essentially, if consumers do in fact always behave rationally in this way as CCT assumes, all consumer mistakes would be avoided.

However, in practice consumer behaviour deviates from this assumption. In my case, my mistake of entering a loan I could not comfortably pay back could have been avoided if I had carefully read and analysed every line of the contract. For every term, clause, word or phrase I did not fully understand, I could have taken my time to get legal advice in order to assist my understanding. If some of the contents was not to my liking, I could have asked to have it removed. And finally, if I did not think the deal overall was fair to me, I could have left it and walked away. In theory, all these options and lines of action are possible, and would have avoided the mistake. However, as will be discussed, for myself and many other consumers like myself at the time of entering my loan, these options are not pursued. This is because consumer behaviour does not in fact allow some potential options which would avoid detriment to be considered. In the absence of having the ability to even consider these options, some mistake will for all intents and purposes be unavoidable.

Consumer rationality is based on the theory that if the typical general consumer is given the required information needed to exercise their freedom to make the choice that is in their best interests, they will make the right choice.<sup>43</sup> Also, where the consumer recognises required information is missing, the consumer will seek out that required information in order to make the decision that maximises their subjective self-interest.<sup>44</sup> The twin theories of CCT and rational consumer theory are inextricably bound: if consumers are shown not to act rationally, CCT breaks down.<sup>45</sup> This is because rational and carefully balanced decision-making is a crucial element that justifies CCT.<sup>46</sup>

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<sup>43</sup> A Sims, 'Unfair Contract Terms: a New Dawn in Australia and New Zealand?' (2012) 39 *Monash University Law Review* 739, at 752.

<sup>44</sup> *Ibid*

<sup>45</sup> *Ibid*

<sup>46</sup> Eisenberg, above n 11, at 212 argues that '[CCT's] empirical premise is that in making a bargain a contracting party will act with full cognition to rationally maximize his subjective expected utility'.

According to CCT, when I entered the agreement to borrow the money to fix my car, I must have gotten the best deal I could, because otherwise, acting rationally I would not have entered that deal. Alexandra Sims however argues that there is a misguided notion that consumers act rationally, and due to this they are often unable to even achieve a fair bargain for themselves, let alone maximise their subjective expected utility.<sup>47</sup> As has been established, individuals will act with self-interest. However, rather than this self-interest equating to the consumer acting rationally and competently to achieve their best interests, behavioural economics suggests that instead a more accurate description would be that consumers act with a ‘bounded rationality.’<sup>48</sup> Through this, they *attempt* to achieve their best interests. An example of this bounded rationality is how a typical consumer behaves when required to enter a SFC with a supplier to obtain a product.

When a consumer desires a product that can only be obtained through entering a SFC, as established, the supplier will be well aware of the contract’s contents. The consumer on the other hand will not know the contents until they have read it. Even though the contract they enter is a legal document that binds the parties to obligations, it has been found that many consumers will knowingly not read the contract and agree to terms they are completely unaware of.<sup>49</sup> This self-imposed disadvantage places the consumer in a severely vulnerable position. Behavioural economics suggests that, in acting within their bounded rationality, the consumer will ignorantly enter pre-prepared contracts like SFCs because they believe it would be in their best interests to not invest the time and effort needed to effectively read and understand them. This thesis submits with reference to research conducted in social science and behavioural economics that the three reasons for borrowers systematically not investing the time and effort needed to read and understand their PL SFCs, including the total cost which the loan may eventually cost them, is because to the average borrower these contracts are inconvenient, irrelevant and incomprehensible.

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<sup>47</sup> Sims, above at n 43, at 753.

<sup>48</sup> Eisenberg, above n 11, at 214. “Bounded rationality” is a term which recognises that consumer rationality can be affected by the consumer’s limited information and limited information processing abilities.

<sup>49</sup> K Tokeley, ‘Introducing a Prohibition on Unfair Contractual Terms into New Zealand Law; Justifications and Suggestions for Reform’ (2009) 23 *New Zealand Universities Law review* 419.

### (i) **Inconvenient**

Inconvenience arises from the timing of the SFC. SFCs are almost always presented at the end of the shopping process, being at the point when the consumer has already spent time and effort deciding upon a product and has made their choice.<sup>50</sup> At this point, it is suggested that the consumer will have developed a perception that they have already committed to the contract prior to even being presented with it.<sup>51</sup> This perception arises from the consumer's self-interest extending to not only attaining what they consider the best product or service at the best price, but also through the easiest process. Consumers in general correlate ease in attaining a product to include not wasting what has already been invested. In this case, time and effort has been invested prior to being presented with the contract.<sup>52</sup> To reject the transaction at the point of receiving the contract due to discovering undesirable terms would waste the time and effort which had already been invested.

In my case of obtaining a loan to fix my car, I had gone to a lot of time and effort by the time the lender had offered me a contract. CCT however expects decision-makers to treat these investments such as time spent shopping as irrelevant factors which should be ignored at the point of considering the contract.<sup>53</sup> However, it has been found from empirical studies that time invested in shopping and examining a product does in fact influence the consumer's decision to accept a contract. Studies show that "a consumer has a greater tendency to continue on an endeavour once an investment of money, effort or time has been made".<sup>54</sup> Moreover, it is predicted that "the larger the past resource investment in a decision, the greater the inclination to continue the commitment in subsequent decision."<sup>55</sup>

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<sup>50</sup> S I Becher, 'Behavioural Science and Consumer Standard Form Contracts' (2007) 68 *Louisiana Law Review* 117, at 125.

<sup>51</sup> Ibid. The psychological phenomena which creates this tendency is broadly known as perception of self-commitment, which includes behavioural attributes such as the sunk cost effect, the cognitive dissonance theory, and the confirmation bias.

<sup>52</sup> Economists refer to this investment as 'sunk costs'. See generally R A Brealey and S Myers, *Principles of Corporate Finance* (12<sup>th</sup> ed, McGraw-Hill Education, Ohio 1996); R Thaler, 'Towards a Positive Theory of Consumer Choice' (1980) 1 *J. Econ. Behav. & Org.* 39, at 47.

<sup>53</sup> This is due to utility maximization assuming that individuals have a stable set of preferences not influenced by irrelevant factors. See Posner, above n 5, at 7.

<sup>54</sup> H R. Arkes and C Blumer, 'The Psychology of Sunk Costs' (1985) 35 *Org. Behav & Hum. Decision Process* 124.

<sup>55</sup> W Samuelson and R Zeckhauser, 'Status Quo Bias in Decision making', (1988) 1 *J. Risk and Uncertainty* 7, at 37.

Timing may also cause the consumer to create a bias to accept a contract. At the time of receiving a SFC, the consumer will have already formed an idea of what the product is, and decided that it is right for them. This bias can work in two ways. First, if consumers discover there are factors which suggest the product or service may in fact not be right, they will be reluctant to give weight to the new conflicting information and instead devalue or ignore any evidence that undermines their choice was a good one.<sup>56</sup> It has been suggested that this can lead to consumers preferring, consciously or not, not to read the contract in fear of discovering unfavourable terms. If the consumer has already decided that they will go ahead with the transaction either way, then it is somewhat understandable that they will not want to be made aware of problems they believe are outside their control.<sup>57</sup>

In my case, once I had received the information that I would be advanced the money I needed within 24 hours I was at a stage of relief, having gone through a stressful time of searching for a lender who would get me the money I needed quickly. At that point I did not really want to know about anything that would dampen my relief and place me back in the position of having to continue my search. I wanted to believe that the loan was the right decision.

Second, individuals who form this type of bias opinion appear to also search for data that supports and confirms their existing opinion.<sup>58</sup> CCT assumes that in order to sufficiently protect the consumer's own interests, a consumer will search for any information that might challenge or contradict a potential or available decision presented to them. However, empirical evidence supports the assertion that this is seldom the case. Once a decision is made usually consumers will cease searching for any information regarding their decision, as it is difficult to eliminate a bias towards a previously held preference.<sup>59</sup>

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<sup>56</sup> Behavioural economists refer to this bias as "cognitive dissonance", which suggests that people are reluctant to hold conflicting ideas simultaneously. See Becher above n 50, 131; See generally E Aronson, *The Social Animal* (12<sup>th</sup> ed, W.H. Freeman & Co Ltd, New York, 2017), 178-179.

<sup>57</sup> Becher, above n 50, 131.

<sup>58</sup> This is described by behavioural analysts as confirmation bias. See S Plous, *The Psychology of Judgment and Decision-Making* (McGraw-Hill Education, New York, 1993), at 233.

<sup>59</sup> Ibid, 238-239.

## (ii) **Irrelevant**

Irrelevance arises from the consumers past experiences. For the majority of contracts like SFCs, their contents will never be used or ever become relevant. Consumers know this through experience, as they will have entered dozens of SFCs within just the first few years of their adult life, and almost all of those SFCs that they entered will never come back to bother them. Each will have been forgotten as the consumer continues on through life, continuously consuming and contracting, without giving any thought to the contractual obligations they may have left in their wake. Economic theorists do not equate this behaviour as lazy or irresponsible, but instead sensible.<sup>60</sup> Consumers need a variety of products and services which require entering contracts. If the consumer was to carefully analysis every contract they encounter, then they would likely have very little time or energy for anything else. In order to function in the world, consumers need to be able to assess risk, and then allocate their time proportionately in response to that level of risk.

Evaluating risk is a demanding, time consuming and challenging cognitive task.<sup>61</sup> In order to reduce the work load, most people will subconsciously employ heuristics<sup>62</sup> in the process of risk evaluation.<sup>63</sup> Although this process of evaluating the risks in decisions will reduce the time and effort needed to make the decision, it will also systematically distort the perception of the risk in a way that is harmful to the consumer's ability to properly evaluate risk allocation.<sup>64</sup> Empirical evidence supports an assumption that consumer risk perceptions within SFCs are

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<sup>60</sup> Eisenberg, above n 11, 214-216.

<sup>61</sup> Becher, above n 50, 141.

<sup>62</sup> Jason Kilbon submits that individuals use heuristics, or mental shortcuts, to assess risk. It is suggested that one such available heuristic is that individuals estimate the probability of risk by reference to their experience or knowledge of the risk. Thus, individuals 'judg[e] risk to be high when the type of harm is familiar or easily imagined and low when it is not.' Moreover, they tend to be overly optimistic about their abilities to avoid risk. A related phenomenon is hyperbolic discounting, whereby 'individuals systematically overvalue immediate benefits and costs and undervalue delayed benefits and costs.' See J J Kilbon, 'Behavioural Economics, Over indebtedness and Comparative consumer Bankruptcy: Searching for Causes and Evaluating Solutions' (2005) 22 *Emory bankruptcy Developments Journal* 13, at 17.

<sup>63</sup> R A Hillman and J J Rachlinski, Standard Form Contracting in the Electronic Age, (2002) 77 *New York University Law Review* 429, at 450.

<sup>64</sup> Becher, above n 50, at 141.

often mistaken<sup>65</sup> or underestimated.<sup>66</sup> This reveals a flaw in the CCT premise, as CCT assumes rational contracting parties will base their decisions on rational risk perception.<sup>67</sup>

Behavioural economists have identified three reasons why consumers form a misperception of risk within SFCs. The first is that consumers tend to equate SFCs to being low-probability risks. This perception of low-probability risk likely stems from the fact that often the only means of attaining a particular product or service is through one particular SFC. Therefore, everyone who has already purchased this product or service has done so by using the same SFC. It could fairly be presumed then that there must be nothing particularly onerous buried amongst the “boring legal stuff”, if “most people”, or the “average person”, are able to use it without detriment. This is also the case when considering the issue of a fair price.

Where there is a set and firm price on a product, then a perception will be formed that the price must be fair, despite how unfair it might otherwise seem. This is due to the consumer correlating through “safety in numbers,” that since many other consumers before them have paid the set price for the product, they cannot be getting cheated on the price. Otherwise everyone else must have also been cheated, as the individual consumer does not tend to believe they are more vulnerable or susceptible to detriment than the average person. In fact, it has been found through behavioural studies that not only does the average consumer mistakenly believe their risk of detriment is never more than that of the “average person”, they in fact believe that their risk is even less.<sup>68</sup> This enhances the perception that the risks within the SFC

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<sup>65</sup> It has been suggested that where there is a misperception of the price/contractual risk trade off, they actually have a misperception over the product itself. See M Spence, *Consumer Misperceptions*, (1979) 44 *Review of Economic Studies* 561, at 561.

<sup>66</sup> Evidence also shows that not only is underestimation of risk a problem, but also under-reaction to risk. It has been suggested that even after recognising the risk, consumers frequently tend to mistakenly react in a sub-optimal way. See Becher, above n 50, at 147. This consumer tendency has been described as a consequence of the psychological phenomena known as “self-serving bias”.

<sup>67</sup> Standard economic analysis, on which CCT is premised, assumes that the rational consumer will have clear and stable risk preferences which are in line with the conventional expected-utility-theory. This theory assumes a rational consumer will evaluate an action in terms of the level of welfare it produces, evaluate uncertain outcomes according to their expected value, and calculate outcomes, probabilities, and values by optimally using available information. See R G Noll and J E Krier, ‘Some Implications of Cognitive Psychology for Risk Regulation’ in C R Sunstein (ed), *Behavioural Law & Economics* (Cambridge University Press, Cambridge, 2000), 325, at 327.

<sup>68</sup> It has been suggested that one reason for consumers not being able to properly evaluate and efficiently respond to some contingency risks is because consumers can often develop an unrealistic belief in their immunity from harm. Behavioural economists describe this tendency to under-react as “self-serving biases”,



are so low that it would be safe to ignore them.<sup>69</sup> However, it is precisely within the “boring legal stuff” that reveals the true, and often unexpected price of some products. It is also here where the allocation of risk is prescribed, as well as the contingency should either party’s expectations not become fulfilled, such as for example the expectation for the required payments on the product.

Even if a contingencies is low risk, it may have severe consequences, like in my case and the contingency should I not be able to make my payments in time. CCT assumes that when applying rational risk perception in situations where the risk is low but the consequences of that risk are high, the consumer will give consideration to that risk.<sup>70</sup> The reality however suggests that such risks are ignored.<sup>71</sup>

The second reason identified by behavioural economists for consumer misperception of risk, which may have been applicable to myself, is that people tend to think that risks are more serious when an incident is readily called to mind, or ‘available.’<sup>72</sup> A consequence of this is

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such as over-optimism and overconfidence. Evidence suggests that people are unrealistically optimistic with respect to many important aspects of their lives. The vast majority of people “believe that their own risk of a negative outcome is far lower than the average person’s,” see C Jolls, C R Sunstein and R Thaler, ‘A Behavioural Approach to law and Economics’, (1998) 50 *Stanford Law Review* 1471, 1541; Evidence also suggests that most people believe they are less likely than others to suffer from automobile accidents, heart attacks, smoking diseases, and other health risks. See N Weinstein, ‘Optimistic Biases About Personal Risks’ (1989) 246 *Science* 1232; It has also been found that consumers often display an unrealistic optimism or overconfidence concerning their general ability and skills. See L A Baker and R E Emery, When Every Relationship Is Above Average: Perceptions and Expectations of Divorce at the Time of Marriage, (1993) 17 *Law & Human Behaviour* 439. In line with this, in Australia, the Competition and Markets Authority research found that many consumers using payday loans were overconfident about their ability to repay their payday loans, and many did not fully comprehend the full cost of these loans. See G North, ‘Small amount credit contract reforms: Have transparency and competition concerns been forgotten?’ (2017) 25 *Competition & Consumer Law Journal* 101, at 121.

<sup>69</sup> The work of cognitive psychologists supports the assertion that consumers encounter serious difficulties in assessing low-probability risks, causing consumers to either underestimate or ignore some risks which ought to be given due consideration. See Becher, above n 50, at 142. Also see Eisenberg, above n 11, at 240. One possible reason that has been suggested for consumers ignoring low-probability risks is to satisfy humans’ natural inclination to eliminate uncertainties, which therefore allows people to simplify the decisions that they face. See Becher, above n 50, at 143. See also D C Langevoort, Behavioural Theories of Judgement and Decision Making in Legal Scholarship: A Literature Review, (1998) 51 *Vanderbilt Law Review* 1499, at 1504.

<sup>70</sup> R Thaler and C R Sunstein, ‘Libertarian Paternalism is Not an Oxymoron’ (2003) 70 *University of Chicago law Review* 1159, at 1162.

<sup>71</sup> Becher, above n 50, at 143.

<sup>72</sup> See C R Sunstein, *Behavioural law & Economics*, above n 63, 5. Or conversely, people tend to underestimate or ignore risks that are “not available.” This consumer tendency has been referred to by behavioural analysts as the ‘availability cascades’. See A Tversky and D Kahneman, ‘Judgment under Uncertainty: Heuristics and Biases’ (1974) 185 *Science* 4157.

that consumers will tend to attach more weight than is warranted to a low probability risk with low potential harm if it is a risk they can relate to. In my case, it is likely I ignored the WG term and the actual cost of the loan due to focussing on the risk of not being able to get the money I needed in time if I delayed in signing the contract. This was likely a small risk, however since I had been in difficult financial situations in the past, I was aware of the difficult short term consequences which can arise when needed cash funds are not available in time. Concentrating on this risk likely caused me to devalued this risk of the WG term.<sup>73</sup>

Research suggests that the WG term is a term often unnoticed or devalued by borrowers, despite suggestions that lenders fully explain this term to the borrower.<sup>74</sup> The extent to what “fully explains” comprises of is uncertain, however if the term was fully explained it would be revealed that the term essentially allocates all the risk from the contract onto the borrower.<sup>75</sup>

### (iii) **Incomprehensible**

Incomprehension arises mostly from information overload. Human memory and cognitive abilities are limited, and the term “information overload” is generally used to acknowledge the fact that consumers have limited processing capacity and can become overwhelmed by a large amount of information.<sup>76</sup> It has been found through studies in behaviour economics that due to consumer’s poor ability at processing large amounts of information, the more factors there are to consider, the more likely they are to give little consideration or even completely ignore a large portion of these factors.<sup>77</sup>

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<sup>73</sup> Where the consumer has not experienced past disputes over standardized contract terms or had their wages garnished, they may not have “available” occurrences capable of recognising the risk which lies within a particular term. See Becher, above n 50, at 145.

<sup>74</sup> See Rob Stock, 2 October 2017. <<http://www.stuff.co.nz/business/money/complaints-grow-about-highcost-shortterm-lenders>>

<sup>75</sup> This is achieved by the term dictating that if the borrower finds themselves in a situation where they will not be able to make the required payments on their loan the lender can elect the right to garnish the outstanding balance directly from the borrowers wages or benefit. Many PL SFCs use the wording “the borrower cannot dispute the garnishment”, or similar wording to that effect.

<sup>76</sup> D M Grether, A Schwartz and L L Wilde, ‘The Irrelevance of Information Overload: An Analysis of Search and Disclosure’ (1986) 59 *Southern California Law Review* 277, at 278.

<sup>77</sup> Becher, above n 50, at 169.

Typical to the contract I entered to secure a loan, the average PL SFC is also usually long. Often these SFCs will run over 10 pages, but can run up to 40 pages. With an average of 6 terms per page, right from the start the borrower is likely to become overwhelmed with information to consider. In addition to this, often the terms will not be clearly presented and contain abundant use of technical legal language.<sup>78</sup> This contributes to the incomprehensibility by alienating them to the average borrower who does not have the legal knowledge required to interpret and decipher the meaning of the terms, or their full effect.<sup>79</sup>

With the SFC being presented at what is likely to be an unexpected time, this gives the impression there is little time to read and consider the document. When presented with a large amount of information with limited time to read and absorb it, it would be an impossible task to thoroughly consider and compare all the relevant data in the time available. This will create an alternative between either, allocating a very small portion of time to each and every term within the contract, or focussing on only a few terms in the contract which the consumer recognises as being important.

With much of the information in a PL SFC, in reality, not being relevant to the borrower, it follows that in order to make an optimal decision it is not necessary for the borrower to consider all the available information in order to reach an “informed” and “rational” decision. Much of the limited time resource would then be wasted if all the irrelevant terms were given equal consideration. If a particular term in a SFC is of greater importance or potentially onerous, naturally more time should be allocated to this, rather than giving the term only the proportionate allocation. Evidence shows that the typical consumer also thinks this way and tends to choose the option of focussing on only a few factors. These factors are what behavioural economists refer to as what the consumer considers to be the ‘salient’ or visible terms within the contract.<sup>80</sup> Eisenberg agrees that in addition to many terms incorporated into

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<sup>78</sup> It has been found that where the information being processed is also complex to the reader, their ability to process the information will decrease dramatically. See C R Sunstein ‘Empirically Informed Regulation’ (2011) *University of Chicago law Review* 1349, at 1361.

<sup>79</sup> F Zumbo, ‘Dealing with Unfair terms in Consumer Contracts: Is Australia Falling Behind?’ (2005) 13 *Trade Practices Law Journal* 70.

<sup>80</sup> See R Korobkin, ‘Bounded rationality, Standard Form Contracts, and Unconscionability’, (2003) *University of Chicago Law Review* 1203, at 1225, where Korobkin describes this process as satisficing information, which is processing the amount of information to the extent that satisfies the minimum requirements necessary to make

SFCs being irrelevant and inconvenient to fully examine, information overload also contributes to most terms being sacrificed as non-salient due to the amount of general information that can be found with respect to any given product.<sup>81</sup>

Although it is necessary to sacrifice all the less important terms, it is still crucial to locate the specific terms which are of most importance and relevance and give that information sufficient consideration. Empirical studies demonstrate that information overload inhibits a consumer's ability to achieve this for three reasons. The first is that the more information that is included in the SFC, the less likely the borrower will be able to recognise the important or potentially onerous terms within the contract. Analysing large amounts of information can cause confusion, and this is especially demanding when that task involves distinguishing between the relevant and irrelevant information. Generally, the more information, the more demanding the task and the more likely the consumer will inadvertently or erroneously devote time to observing the things that do not concern them.<sup>82</sup> In my case, it is likely I devoted a large portion of my attention to irrelevant or less important terms in the first half of the contract and this likely caused me to ignore the WG term and the total price of the contract which was revealed in the second half.

Second, the more information, the more likely the borrower will get frustrated and give up on the task of finding the important terms. It has been argued that information overload can harm consumers if the process of deciding which information to ignore "will make consumers feel frustrated or dissatisfied."<sup>83</sup> Excessive information has in fact been found to cause emotional frustration and dissatisfaction to borrowers using SFCs, since these types of consumers are not usually equipped with the necessary expertise to understand the SFCs they are presented with. It is likely in my case that I also was frustrated by my SFC, as I do admit that I gave up on it halfway through reading it.

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a decision, as opposed to maximizing or optimizing all the relevant information available which CCT presumes the consumer will do.

<sup>81</sup> Eisenberg, above n 11, at 244.

<sup>82</sup> Grether, above n 76, at 285. It has been found that getting confused by superfluous information and mistakenly paying attention to the non-essential information instead of the important will likely contribute to erroneous decision making.

<sup>83</sup> *Ibid*, 285.

Third, even if the borrower is aware of which terms are important, the more information they need to decipher to locate them, the more likely they are to make a conscious decision to abandon the task, deciding that it is not worth the effort. It has been found that irrelevant information can be destructive to consumers who seek certain information “if it raises the costs to them of observing attributes in which they are interested.”<sup>84</sup> If a borrower finds they are spending an excessive amount of time looking for a particular term, conscious of the fact they need to consider other terms and their allocated time may be running out, they may option to abandon the search for the term despite knowing it may be of importance. In this sense, the borrower may interpret the cost of the search as outweighing the benefit.<sup>85</sup>

Often searching will also reveal gaps in understanding which will require more time and effort to be invested with requests for further information. Rather than simply ignoring the relevant information, a borrower may be making a rational decision not to invest time and effort in filling the gaps in understanding, or even searching for the relevant terms at all.<sup>86</sup> This could also very likely be the case when searching for the price if the total price is buried amongst many terms and is determined upon contingencies, such as missing payment deadlines. If a borrower believes they need the loan, they will be conscious of the fact they will ultimately have to accept the contract terms regardless. They will then likely be aware that any time they invest will ultimately be time wasted.

From this it can be concluded that the general consumer does not fit the model of the competent and rational contracting party when presented with a SFC, but instead act in ways that systematically and predictably diverge from rational behaviour.<sup>87</sup> This allows an unacceptably high risk of damaging terms such as the WG term and an objectively unfair price being either ignored, misunderstood, or under-valued.

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<sup>84</sup> Ibid, 286.

<sup>85</sup> Eisenberg, above n 11, at 243.

<sup>86</sup> This has been described as “rational ignorance”. In other words it would be irrational for a consumer to invest the time needed in order to request and understand all the information needed in order to effectively read every term in the SFC. See R E Barnett, ‘Consenting to Form Contracts’ (2003) 71 *Fordham Law Review* 627, 631.

<sup>87</sup> J Kilborn, ‘Behavioural Economics, Over-indebtedness and Comparative Consumer Bankruptcy: Searching for causes and Evaluating Solutions’ (2005) 22 *Emory Bankruptcy Developments Journal* 13, 17; See also Becher, above n 50, at 123;

Despite the dangers bounded rationality poses to the borrower, the greater the reliance of the borrower to the lender, the less the need for the lender to compromise their systems in favour of the borrower. This moves to the third problem with PL SFCs, being an inequality in bargaining power. CCT assumes parties to a contract will be on equal ground during the contracting process, however where an extremely weak borrower contracts with a strong lender, even if the borrower was able to discover and understand the risks of onerous terms like the WG term and recognise the bundled unfair high price of a loan, their weak position of reliance would likely mean any attempts of negotiation or requests for an amendment would be met with a take it-or-leave-it response. This is especially the case when a weak third tier borrower contracts with a payday lender.

### **C. Unequal Bargaining Power**

Although it has been stated the presence of a SFC will usually not allow any opportunity to negotiate, there may in fact be situations where there is an opportunity to negotiate on some terms, and in some instances the price of the product or service. This may be where the bargaining power of the two parties is closely balanced, as the assumption of freedom of negotiation also works on the basis that the parties to the contract negotiate equally on terms that accord with their interests. In regards to this assumption of freedom to negotiate, where one party is significantly stronger than the other, there is a danger that there will not be an opportunity for the weaker party to engage in any effective negotiation at all.<sup>88</sup>

In the case of severe unequal bargaining power, even when the consumer does have some understanding of the effect of a term and the total price, they will likely have little to no say in altering it. In my case of obtaining a loan, the other party to the contact was a third tier lender, similar to a payday lender. To understand the vulnerability unequal bargaining power can

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<sup>88</sup> J Malbon, 'Predatory Lending' (2005) 33 *Australian Business Law Review* 224.

create when the general consumer using a PL SFC, it is useful to investigate the characteristics of the payday lender.

### (i) **The Payday Lender**

The New Zealand credit industry consists of first, second and third tier lenders. Typically first tier lenders are registered banks, second tier lenders are building societies or credit unions, and third tier lenders are identified as credit providers or finance companies. Payday lenders are lenders which fall into the category of third tier lenders. These types of lenders will often specialise in small cash loans with short repayment terms. Loans of this nature are traditionally expensive lines of credit. Prior to the cost of credit caps and interest rate caps introduced into New Zealand, PL SFCs usually carried an interest rate from 150% per annum up to 803% per annum depending on the amount borrowed and duration of the loan.<sup>89</sup>

Evidence suggests that New Zealand has seen a rapid growth in the payday lending market over the past decade and a half.<sup>90</sup> This has also been the case in many other jurisdictions.<sup>91</sup> With so many payday lenders now operating in the market, under the normal market forces it

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<sup>89</sup> Payday Lender Ferratum has an advertised interest rate of 803% in their standard form contract for a \$500 loan lent over a duration of 7 days.

In Australia prior to interest rate caps being introduced the interest charged on payday loans ranged from 48% per annum to as high as 1500% per annum, as per National Legal Aid, Submission No 19 to Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, 14 October 2011, 2, cited in Consumer Credit and Corporations Joint Committee Report, [5.87].

The typical payday loan in the United Kingdom is around the equivalent of \$NZ1000 and is loaned for a duration of 25 days. Prior to the United Kingdom introducing interest rate caps it was not uncommon for payday lenders to charge 1500% interest on their loans, with Wonga, the United Kingdom's largest payday lender reportedly providing a loan at close to 6000% interest, as reported in the Guardian on June 27 2012 by H. Osbourne in "Payday Loans- the industry in Numbers."

<https://www.theguardian.com/money/2013/mar/06/payday-loans-industry-numbers>

<sup>90</sup> The review of the consumer credit regulation in June 2018 identified that currently there are approximately 340 active registered lenders in New Zealand. This is an increase from 218 registered lenders in 2011.

The Ministry of Consumer Affairs Regulatory Impact Statement: Responsible Lending Requirements for Consumer Credit Providers (14 October 2011) cited that there was also a 60% increase in the number of third tier lenders in New Zealand between 2006 and 2011, resulting in 127 new lenders entering the market during that time.

<sup>91</sup> The largest payday lender in the UK, Wonga, increased its profit margin 36% from 2011 to 2012, making \$150million for the financial year. The concern in the UK is that these huge margins are at the expense of the lowest income earners, and is mostly the surplus of what these low income earners are paying for their essentially day to day consumptive needs. Wonga Group Limited, 'Annual Report 2012', 2 and 7.

would be expected that due to the increased competition, the lenders in the market would be driven to offer competitively lower priced options for credit in order to survive. CCT protection in fact specifically relies on a product price decrease for a market supply increase.<sup>92</sup> However, it has been found that increased competition has not affected the fees charged and interest imposed in the small loan market in the way that “one normally thinks competition will affect loan market interest rates”.<sup>93</sup> In fact, generally within the industry, fees and interest had increased in the last few years prior to the legislative intervention, from what was argued as already being unfair or even oppressive.<sup>94</sup>

The payday lending industry lobbied heavily against the legislative substantive protection and cost of credit caps prior to it being introduced in New Zealand, Australia and the United Kingdom. This was against both their interest rates and fees, arguing that market forces will ultimately lean in favour of the consumer.<sup>95</sup> Their argument was based on the theory of free-market economics where the correct or fair price for a product, with the attached correct or fair terms, will eventually be established. This assumes that competing lenders will be forced to provide their service at the price and with terms which borrowers ultimately regard as fair. Under normal market forces those lenders that do not will lose business and ultimately get pushed out of the market.

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<sup>92</sup> Epstein, above at n 4.

<sup>93</sup> Mark Flannery and Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* (Federal Deposit Insurance Corporation, Working Paper 2005/09, 2005) at 10

<sup>94</sup> See North, ‘Small Amount Credit Contract Reforms: Have Transparency and Competition Concerns Been Forgotten?’, Above at n 67, at 103-105; See also Competition and markets Authority, Government of United Kingdom, *payday Lending Market Investigation: Final report* (24 February 2015); Evidence shows that increased competition among payday lenders in the United States has also reduced bargaining leverage to consumers and exacerbated the problem of borrower delinquency due to excessive solicitation and over-lending. See L Drysdale & K Keest, ‘The Two-Tiered Consumer Financial Services marketplace: The Fringe Banking System and Its Challenges to Current Thinking About the Role of Usury laws in today’s Society’, (2000) 51 *South Carolina Law Review* 589, at 661.

<sup>95</sup> See the Australian Prudential Regulation Authority, *Submission to Financial System Inquiry* (31 March 2014); See also *The Australian Consumer Law and Unfair Contract Terms- Fact Sheet* (2009); See also Ministry of Business Innovation & Employment, *Review of Consumer Credit Regulation Discussion Paper* (June 2018): See also Business NZ, *Submission to the Ministry of Business, Innovation & Employment on the Review of Consumer Credit Regulation Paper* (August 2018).



However, there was no evidence of this occurring, suggesting that protection from free market mechanisms failed in that particular industry.<sup>96</sup> Free market economics would suggest that increased competition will result in increased bargaining power for the consumer. If the consumer must pay more for the product with the increased competition, it would seem the more payday lenders that enter the market the more the borrower's bargaining power reduces. This failure in market systems likely stems from the payday lender knowing that there is a large market of consumers relying on third tier credit due to the large portion of consumers excluded from mainstream credit.<sup>97</sup> In fact, the entire fringe credit market exists solely because of financial exclusion. For this reason payday lenders have incorporated the predominant characteristic of availability and inclusivity as key factors into their business model.<sup>98</sup> They can accommodate higher risk consumers where mainstream lenders cannot by including in their credit contracts terms such as the WG term and the direct debit authorisation term.<sup>99</sup>

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<sup>96</sup> If the industry were correct about free market mechanisms protecting consumers, then the 50% increase of payday lending stores (approximately 120 new stores) since 2009 should have lowered interest rates and fees on payday loans. Empirical evidence, however, shows that competition among payday loans stores has not given any bargaining leverage to consumers. In fact, as Pearl Chin suggests, at Chin, *Payday Loans: The case for Federal Legislation*, above n 31, at 740, the converse is true: Despite the aggressive and explosive growth of the industry, competition among lenders has not resulted in fairer prices for consumers. It is suggested that this is due to an absence of credit alternatives.

<sup>97</sup> Rob Stock wrote in Stuff on 13/4/2014 in "Informal Loans rate High" that New Zealanders have one of the highest reliance on informal loans even though we have one of the highest access rates to bank accounts, being 98.7%. 11% on all loans granted in 2013 were informal loans from third tier lenders.

<http://www.stuff.co.nz/business/money/9932153/Informal-loans-rate-high>

Actual figures for third tier borrowers in New Zealand is not yet available, however an estimated 130,580 people used third tier lenders between 2009 and 2011, as per The Ministry of Consumer Affairs Regulatory Impact Statement: Responsible Lending Requirements for Consumer Credit Providers (14 October 2011), above at n 90.

<sup>98</sup> Payday lender advertisements will generally emphasise firstly the ease and speed with which credit can be obtained. Common advertise phrasing includes "Need Cash fast?", "Same day Approval," "Cash Within 24 Hours". Second to this it is heavily emphasised the availability of credit to all consumers regardless of their credit history or financial situation. Typical advertised phrasing includes, "Beneficiaries OK," "Poor Credit? No Worries," "Past Problems, No Problem."

<sup>99</sup> An example of such deduction terms is that used by payday lender Moola which states:

#### AUTHORITY TO DEDUCT

5.1 Salary and wage deduction: The Borrower agrees that, if the Borrower has not paid any amount owing to the Lender when due, the Lender may deduct that amount directly from the salary or wages of the Borrower and consents to the Lender contacting the employer of the Borrower to effect such deduction. The Borrower's attention is drawn to section 5(2) of the Wages Protection Act 1983 which allows the Borrower to withdraw this consent for a deduction from wages or salary. To withdraw the consent the Borrower must give written notice to the Borrower's employer (subject to the notice periods specified in section 5(2)) with a copy of that notice to the Lender.

5.2 Direct debit: The Borrower authorises the Lender (until further notice in writing) to debit by way of a direct debit from any account or accounts that the Borrower holds with any bank or other financial institution, every amount due under the Credit Agreement.

5.3 Debit card charges: The Borrower authorises the Lender to charge every amount due under the Credit Agreement to any debit card held by the Borrower. The Borrower shall provide the Lender with the necessary debit card details to make the payment and give all such payment instructions to a debit card issuer as the Lender may require for this purpose.

The profit available in small short term loans were previously catered for firstly with the extremely high interest rates, which as stated reached up to 803% per annum. The industry justified the high interest rates on their loans as “proportional to the risk undertaken and the service provided” to borrowers who are ignored by traditional financial institutions,<sup>100</sup> and thus argued these rates as being uncontroversial.

The second mechanism which creates sustainable profits to payday lenders, and which is much more controversial, is a system which payday lenders use to draw out the duration of the short term loan to their profitable advantage and financial ruin of the borrower.<sup>101</sup> This system is broadly referred to as a “roll-over option”<sup>102</sup> attached to a PL. This relies on the contingency of the borrower not adhering to the repayment conditions of the loan. This roll-over option has been cited as the one of the most dangerous features of PLs.<sup>103</sup> Not only does this option present severe potential detriment to the borrower,<sup>104</sup> evidence suggests that many third tier lenders

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Similar clauses are used in both Australia and the United Kingdom. In the United Kingdom loans are typically repaid through the continuous payment authority, which is a direct debit system.

<sup>100</sup> S A Schaaf, ‘From Checks to Cash: The Regulation of the Payday Lending Industry’ (2001) 5 *North Carolina Banking Institution* 339, at 349.

<sup>101</sup> Consumers who default on high-cost loans, or seek loan extensions, can end up with unmanageable debt and in financial hardship, even if the original loan was affordable. This is because, if not paid off quickly, high interest rates and fees can result in the rapid accumulation of the loan amount. See “Review of consumer credit regulation: Additional information to support the discussion paper” June 2018, Ministry of business innovation and employment, at page 13.

<sup>102</sup> See Chin, above n 31, 729-330. The “roll-over” option is an option which involves extending the duration of the loan to avoid defaulting on the loan. This will involve interest on the initial loan increasing exponentially, often resulting in the borrower remaining in a perpetual cycle of debt.

<sup>103</sup> . Chin, *Ibid*, at 729; Testimony of Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America, Before the Forum of payday lending 4 (Dec. 15, 1999).

In the United States in a testimony before Senator Joseph Lieberman’s Forum on Payday Lending, Jean Ann Fox, Director of Consumer Protection at the Consumer Federation of America, presented evidence on 15 December 1999 before the Forum of Payday Lending of multiple borrowers who found themselves buried under a mountain of debt because of multiple rollovers. This is also reflective of the situation in many jurisdiction, including New Zealand, Australia and the UK. It was also identified however from the evidence gathered that the rollover option is only the first part of the system which leads to the debt spiral. The second part of the system relies on the fact that a sufficient proportion of borrowers will either choose the roll-over option or be forced to use that option. See also Malbon, above n 88, at 225; See also ‘What Financial Counsellors Say about Payday Lending’ (Research Report, October 2011) (‘Financial Counselling Report’). Here it was suggested that the main reason for low income Australians getting into debt spirals was due to the rolling over of short term loans, which resulted in higher levels of interest over a much longer period of time. It was then identified that the most detrimental feature of third tier credit in Australia is the likelihood of the loan being rolled over, or another loan being taken out to pay the interest on the loan.

<sup>104</sup> In the First reading of the Credit Contracts and Financial Services Law Reform Bill 2013 on 17 September 2013, Julie Genter representing the Green party noted that debt spirals were rampant amongst fringe credit borrowers and cited an instance of where an initial \$800 loan spiralled into a \$70,000 debt. Genter argued that the cause

have established business models relying on the likelihood that a customer will be unable to repay the initial loan.<sup>105</sup>

Since larger profits can be generated by the PL from the roll-over option through high default fees and default interest, providing a loan to a consumer that can be comfortably repaid will likely run counter to the lender's interests.<sup>106</sup> For this reason PLs have been accused of targeting a certain type of borrower who will typically behave a certain way, typically possess certain characteristics, and typically exist in certain circumstances. This type of borrower is typical a vulnerable borrower, rather than the average borrower. It has been suggested that lenders who actively seek out financially vulnerable members of a community to extend them loans, knowing they will likely have difficulty repaying them, is a predatory practice,<sup>107</sup> socially corrosive and harmful.<sup>108</sup>

When a particularly strong party to a contract like a lender presents these contracts to weak, or even vulnerable borrowers, there will be a strong temptation to use their advantage to present a contract which is overly beneficial to themselves, even to the point which results in the

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of many of these debt spirals was due to the large interest rates on the loans coupled with the loans being rolled over.

<sup>105</sup> There has been many allegations that this business practice of many third tier lenders in deliberately targeting borrowers who will have difficulty in adhering to repayment conditions is resulting in significant consumer detriment, See Ministry of Consumer Affairs *Regulatory Impact Statement: Responsible Lending Requirements for Consumer Credit providers* (14 October 2011) at n 90, at 4.

Similar to this, in the United Kingdom, The Financial Conduct Authority (FCA) have formed the view that payday lenders in the United Kingdom have a deliberate business strategy to make loans to vulnerable borrowers who cannot afford the loans, as per the Financial Conduct Authority Consultation Paper CP14/10 "Proposals for a price cap on high-cost short-term credit" July 2014. <https://www.fca.org.uk/publication/consultation/cp14-10.pdf>

Such lending practices have been have been described by Justin Malbon and generally labelled as predatory lending. See Malbon, above n 88, 25; It is lenders who engage in irresponsible lending practices like this which result in severe financial hardship and spiralling debt that the Ministry of Consumer Affairs refers to as "loan sharks"; See also Cabinet Business Committee *Responsible Lending requirements for Consumer Credit providers* (Ministry of Consumer Affairs, October, 2011) at 2.

<sup>106</sup> Ministry of Consumer Affairs *Regulatory Impact Statement*, above n 90, at 8.

<sup>107</sup> According to the lobby group Acord.com (Association of Community Organisations for Reform Now), predatory lending involves "imposing unfair and abusive loan terms on borrowers, often through aggressive sales tactics, taking advantage of borrowers' lack of understanding of extremely complicated transactions, and outright deception".

<sup>108</sup> Malbon, above n 88, 225. It has been acknowledged here by Malbon that predatory lending it is not the root cause of poverty and indebtedness. Instead it has been described as an opportunistic practice and symptom of deeper failures within social policy and economic systems. . It does not need to create vulnerability to survive, as this characteristic is already abundant from existing problems, such as poverty, social exclusion, and addictions such as drugs, alcohol and gambling.

contract being overly unfair. This is especially the case where the other party to the contract is extremely weak and vulnerable. Possibly the weakest and most vulnerable of all consumers as a class of consumer is the typical PB.

## (ii) **The Payday Borrower**

As stated previously in the example of entering a credit contract to repair my car, had I optioned to continue in that contract through the option of the roll-over option, it would have most likely led to an objectively unfair situation for myself and most likely ultimately resulted in a debt spiral. However, although I willingly entered a contract detrimental to my own self-interests, it has been submitted that I acted typically to how a consumer in my position would have acted. My position being at the time of entering the loan agreement was a consumer who had very little savings, a low fixed income, no house, assets of low value, and very limited access to credit.

In New Zealand there has been limited research conducted on the nature of typical third tier borrower or PB. However, from the research that has been conducted, it has been suggested that consumers who have low incomes, cash problems, existing debts, low savings, lack of alternative financial assistance and poor credit ratings predominately create the demand for loans from third tier lenders. It has been found that many of these borrowers are also often receiving benefits, do not own their own home, or have very low equity in their home.<sup>109</sup>

In the First reading of the Credit Contracts and Financial Services Law Reform Bill 2013 on 17 September 2013, Julie Genter representing the Green party noted that 44% of third tier borrowers were using the credit to purchase essential items.<sup>110</sup> The review of consumer credit

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<sup>109</sup> See C Brunton *Using a third tier lender: experiences of New Zealand borrowers* (Minister of Consumer Affairs, August 2011) at 26.

Although the majority of borrowers meet this profile, there is also evidence from studies and in overseas jurisdictions that consumers with relatively high levels of financial literacy and awareness of associated costs also still enter into loans with third tier lenders on unfavourable terms. See Malbon, above n 88, 225; See also E Warren and A Warren Tyagi, *The Two-income Trap: Why Middle-class Mothers and Fathers are Going Broke* (Basic Books, New York, 2003); See also J Sullivan, 'The Two-income Trap: Why Middle-class Mothers and Fathers are Going Broke. By E Warren and A Warren Tyagi' (book review) (2004) 27 *Harvard Woman's Law Journal* 273.

<sup>110</sup> Evidence of this was supported by Clare Curran representing Labour and referencing findings from catholic Social Services, Anglican Family Care, Methodist Family Mission, Presbyterian Support and the Salvation Army.

regulation conducted by Ministry of business innovation and employment in June 2018 (The Review of Consumer Credit) included a survey of 74 Māori Housing New Zealand tenants who frequently used PL SFCs. The survey found a significant number of these tenants had overdue household bills. 89% of tenants said that they “ran out of food due to lack of money at least sometimes”, with many running out of food every week.<sup>111</sup> This suggests that the typical PB is desperate and has trouble living from week to week.

It has also been found that the typical PB lacks financial literacy, which includes lack in knowledge of rights and the impact of loan terms and high interest rates.<sup>112</sup> This frequently results in the typical PB entering loans with large amounts of existing debt.<sup>113</sup> The Review of Consumer Credit cited two Whānau Ora sub-providers (one working with Pacific people and the other with Māori) had advised that most of their client families were struggling with unmanageable debt.<sup>114</sup> Catriona MacLennan in her article titled “cap an easy way to protect vulnerable from loan sharks”<sup>115</sup> concluded that the typical payday borrower in New Zealand was in a weak, desperate and vulnerable position, and in need of immediate protection.<sup>116</sup>

In Australia, which has very similar economic patterns in relation to the payday lending industry in New Zealand, there has been extensive research conducted on the typical third tier borrower. Data from Digital Finance Analytics<sup>117</sup>, a study derived in 2015 from longstanding

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<sup>111</sup> Ministry of business innovation and employment, Review of consumer credit regulation: Additional information to support the discussion paper June 2018, at 10.

<sup>112</sup> Brunton, above at n 109, at 4. Within New Zealand, evidence suggests that indigenous, Pacific and other ethnic minority communities are most at risk of financial exploitation due to financial illiteracy. See also, M Anae, *Pacific Consumers' Behaviour and Experience in the Credit Market, With Particular Reference to the 'Fringe Lending' market* (Ministry of consumer Affairs, August 2007) at 11; It has been suggested that this is the reason why most fringe lenders are located in lower income communities, particularly South Auckland. See Ministry of Consumer Affairs *Third-tier Lender Desk-based Survey* 2011, (July 2011)

<sup>113</sup> The Review of Consumer Credit, *Ibid*, at 10, noted one social service provider that works with low income families advised that 95% of its 900 client families were carrying unaffordable debt.

<sup>114</sup> The Review of Consumer Credit, *Ibid*, at 10.

<sup>115</sup> Catriona MacLennan, *cap an easy way to protect vulnerable from loan sharks* (2014) [https://www.nzherald.co.nz/personal-finance/news/article.cfm?c\\_id=12&objectid=11250619](https://www.nzherald.co.nz/personal-finance/news/article.cfm?c_id=12&objectid=11250619) at 7 May 2014.

MacLennan noted that the vulnerable are deceived into a spiral of debt by such slogans as “no credit checks”, “bankrupt ok”, and “lend to beneficiaries”. Then, once you’re in, you are at the mercy of the lender, as they can charge you whatever they want, and there are no rules against them doing that.

<sup>116</sup> Ministry of Consumer Affairs Regulatory Impact Statement, above at n 90.

<sup>117</sup> G North, ‘Small Amount Credit Contract Reforms in Australia: Household Survey Evidence and Analysis’ (2016) 27 *Journal of Banking and Finance Law and Practice* 203, at 203.

household surveys,<sup>118</sup> suggests the profiles of households who use loans from third tier lenders in Australia differ markedly from the general population in terms of socio-economic factors, levels of indebtedness, and credit and banking experiences. This data indicates that the average income of these borrower households in 2015 was around \$36, 000 and only 9 per cent had incomes over \$50, 000. Most of these households with an employed primary earner had relatively low-skilled positions, education levels restricted to high school, a limited understanding of financial matters, and a need to rely on multiple part-time positions for income. The combined data suggests most consumers using small amount short duration loans in Australia are vulnerable and disadvantaged in some way.<sup>119</sup> The data from the research of Digital Finance Analytics also showed that 58.7 per cent of borrower households indicated that the reason for using third tier credit was because it was the only credit option available to them. This would indicate that many of these borrowers had attempted to access mainstream credit in the past, but had been rejected.

Dean Wilson's research into payday lending in Victoria in 2002 for the Consumer Law Centre Victoria<sup>120</sup> provided detailed analysis of 78 payday borrowers interviewed in a "street survey" leaving payday lending establishments. Wilson concluded from his research that borrowers usually resort to payday lenders because of ongoing financial problems which stemmed from fixed low incomes, impaired credit ratings due to a history of delinquency in making payments for credit, inability to obtain alternative credit, lack of alternative financial assistance, low value or low equity in assets, low ability to absorb financial shock and existing credit over-commitment.<sup>121</sup> These combined characteristics of these consumers pose a significant financial risk to mainstream lenders who do not have the systems in place to cater for such risks. These borrowers are also undesirable due to the type of credit they require, being small amounts. Large volumes of small value loans do not fit easily into the business models of banks.<sup>122</sup>

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<sup>118</sup>This study was undertaken in conjunction with Monash University Centre for Commercial Law and Regulatory Studies (CLARS) and commissioned by Consumer Action Law Centre, Good Shepherd Microfinance, and Financial Rights Legal Centre.

<sup>119</sup> North, 'Small Amount Credit Contract Reforms: Have Transparency and Competition Concerns Been Forgotten?' (2017), above n 67, 121.

<sup>120</sup> D Wilson, *Payday Lending in Victoria- A Research Report* (Consumer law Centre Victoria Ltd, 2002).

<sup>121</sup> See Wilson, *Ibid*. It was acknowledged from the surveys however that these consumers often first come to use PLs due to some singular event which causes 'financial shock'.

<sup>122</sup> *Ibid*, at 84. See also M S Barr, 'Banking the Poor', (2004) 21 *Yale Journal on Regulation* 121, at 121. Mainstream providers have largely withdrawn from the small loans market, possibly due to lack of profitability in this market. High costs relative to principal of providing small loans mean higher relative charges are necessary to make a

Although some of these borrowers would have approached the payday lender before investigating whether cheaper options of credit were available, with the characteristics typical of the PB, it is likely that rather than being ignorant, these borrowers are instead realistic. Wilson's research confirms this theory by suggesting that consumers do not always use PLs due to ignorance about the existence of other lenders offering better rates of interest and other loan terms,<sup>123</sup> but instead because they are the last resort for the financially excluded seeking credit.<sup>124</sup> Malbon also suggests that the third tier borrower is not ignorant to their options, but are instead financial vulnerability due to mainly having limited options for dealing with a financial crisis.<sup>125</sup> Malbon continues by suggesting that this third tier consumer trait is the biggest asset to the PL industry,<sup>126</sup> and according to some respondents to the Wilson survey,

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profit, as administrative costs and loss provision can often be equal to large, long-term loans. According to Wilson, it is the banks' failure to cater for these consumers that, in part, has facilitated the emergence of payday lending.

<sup>123</sup> Wilson, above n 120, at 77. Wilson submits that those interviewed were not ignorant to the basic cost of their credit through a PL or the comparative cost of a mainstream lender. One consumer interviewed in Wilson's survey, at 73, said that: "Banks are cheaper, but when I started using them [payday loans] no one would touch me with a ten-foot pole because of my credit rating." Another borrower surveyed said, at 76: "I wouldn't use them unless I had to. If I could I would go to the bank to get a loan." Others from the survey said, at 77, "they're a rip off, but they give you money and who else is going to lend to someone who's unemployed".

Wilson concluded at 77 that the combined results of the survey showed that these borrowers "knew how much they were required to repay and were generally aware of potential penalties involved with the loan". It was acknowledged however that should contingency fees start being included, the ultimate cost of the credit may become a surprise. He also concluded that although very few consumers interviewed in his study had any comprehension of annual percentage rates, this ignorance "probably reflects a more general lack of understanding in the wider community", rather than isolated to the third tier borrower, see at 77.

<sup>124</sup> Evidence from studies and in overseas jurisdictions have found that consumers with relatively high levels of financial literacy and awareness of associated costs also still enter into loans with third tier lenders on unfavourable terms due to financial exclusion; See E Warren and A Warren Tyagi, *The Two-income Trap: Why Middle-class Mothers and Fathers are Going Broke* (Basic Books, New York, 2003), above at n109; See also J Sullivan, 'The Two-income Trap: Why Middle-class Mothers and Fathers are Going Broke. By E Warren and A Warren Tyagi' (book review) (2004) 27 *Harvard Woman's Law Journal* 273; See also Brunton, above n 109, at 13 where it is suggested that acquiring a loan on unfavourable terms may not be due to a lack of "shopping around" to determine what loans may be on offer through other lenders. For many borrowers their credit ratings, existing debts and security they can offer means that third tier credit is their only option for borrowing money for essentials. Even if they were to "shop around" the result may be no different, as likely the only borrowers willing to lend would be charging similar high costs with similar terms;

<sup>125</sup> Marbon, above n 88, 225. Malbon suggests that consumers who have a lack of options in securing finance are usually aware of this, so concede to the fact they will need to use a PL and hence agree to the terms and cost of the credit. Malbon also suggests financial vulnerability stems from a number of circumstances and may be temporary or enduring. Some members of the community are more prone than others to financial vulnerability because of their geographical location, race, age or marital status.

<sup>126</sup> Marbon, *Ibid*, at 225.

vulnerable consumers will even continue to take out PLs when they have been “financially burnt” by the experience in the past.<sup>127</sup>

Findings from the research data of Digital Finance Analytics further showed that 13.3 per cent of respondents said they sought the loans out of desperation.<sup>128</sup> This indicates that at the time of seeking the loan, timing was a crucial factor. The typical traits of these borrowers mean they will not have the financial resources to deal with unexpected expenses. When the expenses are for essentials, the consumer will often be under pressure to obtain the finance, so there will often be no choice but to use a lender who can provide the funds immediately. Even where a borrower may have some access to mainstream credit, the time it may take to have the funds advanced and the risk of being rejected may mean the borrower is pushed to third tier credit before having a chance to investigate other options. In such cases the borrower may also be so focused on getting the money immediately that little attention is even paid to the details of the PL SFC.<sup>129</sup> In many cases where the PB is in a particularly desperate situation, it will not only be the “hidden terms” in fine print that are overlooked, but even the cost of the loan.

Finally, the research of Digital Finance Analytics also showed that 28 per cent of the borrowers surveyed used PLs because they thought the source of funds from the PL was convenient.<sup>130</sup> Generally, short-term micro loans from PLs are undeniably the most expensive forms of credit available. Although the total cost of the loan may be unclear, interest rates on the loans are one of the few factors clearly visible, with the difference in the interest rates being clearly identifiable. If a consumer has access to credit from a first or second tier lender, then it would be irrational for that consumer to enter a credit contract with the more expensive third tier lender solely due to convenience. It has been established that consumers act with “bounded rationality”, however it has also been established that they also act in their best interests. From this, “bounded rationality” will not extend to explaining why a consumer would choose an

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<sup>127</sup> Wilson, above n 120, at 79.

<sup>128</sup> North, ‘Small Amount Credit Contract Reforms in Australia’, above n 67. This data identified a further segment of consumers defined as being in “severe financial difficulty”. Analysis of this segment revealed that of this group, 95 per cent of the households indicated that third tier loans were chosen out of desperation.

<sup>129</sup> Brunton, above n 109, 19.

<sup>130</sup> North, ‘Small Amount Credit Contract Reforms in Australia’, above n 67. Of the households which indicated the reason for entering the loan was convenience, it was identified that these borrowers were consumers that had various forms of outstanding debt and were in earlier stages of financial stress.



easily identifiable inferior product over a superior one. For these reasons, it seems unlikely that convenience was the sole reason that 28 percent of those surveyed choose a third tier line of credit if there was another option available.

It is suggested that in many of these cases the borrower has confused the term ‘convenience’ with ‘most probable ultimate outcome’. Where a borrower is undesirable to mainstream credit, especially if they have large existing debt and a history of financial delinquency, they will likely know they are undesirable, and at least be aware of the high risk of being rejected from mainstream credit. For consumers with bad credit ratings then, rather than PLs being convenient, the fear of rejection is more likely the factor for these consumers approaching payday lenders before investigating other options. This will be especially so if they have been rejected in the past.

In contrast with this, there is a high probability that the payday lender will not reject the consumer with bad credit, as another typical characteristic of payday lenders is that they are very welcoming and usually treat all borrowers as a valued customer.<sup>131</sup> Therefore, in acting rationally on this knowledge, all these borrowers surveyed, including those who identified convenience as the reason for using the PL, likely choose not to waste time and effort to pursue the option of mainstream credit as they identified this option as having both a low probability of success and carrying the added disincentive of fear of hurt feelings, belittlement and embarrassment that accompanies rejection.

The United Kingdom is another jurisdiction where extensive research has been conducted on the characteristics of the typical PB. Research suggests that the typical PB in the United Kingdom usually has three characteristics. The first is a low and fixed income, confirmed by Consumer Focus in 2010 conducting an extensive study on the typical PB in the United Kingdom.<sup>132</sup> The findings of the UK National Audit Office in their investigations into third tier

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<sup>131</sup> Wilson, above n 120, at 76. One respondent to Wilson’s survey was typical in her response about the service provided by her PL: “They were excellent in the way they treated you as a person. They didn’t treat you in the way that you get treated because you’re on a pension. They treated you as if you were a client that was worth being treated well.”

<sup>132</sup> M. Burton, ‘Keeping the Plates Spinning: Perceptions of Payday Loans in Great Britain’ (Consumer Focus Research Report, August 2010), at 21.

credit users also found this characteristic.<sup>133</sup> In 2013, the University of Bristol did an extensive study on payday lending and the borrowers effected. The study was commissioned by the Department for Business, Innovation & Skills (BIS) and was published in March 2013 in “The Impact on Business and Consumers of a Cap on the Total Cost of Credit” which also showed that PBs are consumers living typically well below the average UK national average.<sup>134</sup>

The second common characteristics the UK research found amongst these borrowers resorting to payday loans was lack of access to alternative credit products.<sup>135</sup> The reasons for this financial exclusion from alternative credit options has been found to be poor credit history, unemployment, and exhausted credit limits on credit cards or bank overdrafts.<sup>136</sup>

The third characteristic was that these borrowers had an urgent need to access the credit. It was found that the most common reason for borrowers using payday loans in the United Kingdom was to pay for everyday expenses, including recurrent household bills such as food and utility bills, to bridge short-term shortfalls between income and expenditure.<sup>137</sup> These types of expenses are therefore for essentials, so they cannot be postponed. This then leaves the borrower in a desperate and vulnerable position. From the combined research it can be concluded that the typical PB is vulnerable, desperate and excluded. This is a significant factor when considering the minimal bargaining power the borrower has when entering a SFC with the significantly stronger payday lender.

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<sup>133</sup> National Audit Office, ‘Report by the Comptroller and Auditor General: Regulating Consumer Credit’ (December 2012), at 8 and 18; See also, Competition and Markets Authority, Government of the United Kingdom, *Payday Lending market Investigation: Final Report* (24 February 2015), at 4 which showed similar findings.

<sup>134</sup> University of Bristol, ‘The Impact on Business and Consumers of a Cap on the Total Cost of Credit’ (Personal Finance Research Centre, March 2013), at 16.

<sup>135</sup> Office of Fair Trading, ‘Report 1481: Payday Lending Compliance Review Final Report’ (March 2013), at 29; See also, Office of Fair Trading, ‘Report 1232: Review of High Cost Credit Final Report’ (June 2010), at 9; See also, University of Bristol, *Ibid*, at 16.

<sup>136</sup> University of Bristol, *Ibid*, at 25.

<sup>137</sup> *Ibid*, at 19. It was found that almost two-thirds of the payday loan borrowers surveyed had used their most recent payday loan to meet the basic costs of living such as food and utility bills, at 112 and 117.

It has been submitted in this first section that when the general consumer enters a PL SFC they are in a severely weak position to *recognise* their best interests. This is due to their rationality being severely bounded during the contractual process of entering a SFC. The general consumer also has a severely reduced opportunity to effectively negotiate the terms of their contracts and *pursue* their best interests. In addition to this, due to their vulnerability from the unequal bargaining power, they are in a difficult position to *achieve* their best interests. This present a strong justification for granting legislative consumer credit protection to the general consumer when entering third tier consumer credit SFCs.

The examination of the typical PB in this section demonstrated that they typically have external vulnerability characteristics beyond that of the general consumer. It has been found that these borrowers are usually financially excluded, have low fixed incomes, have minimal assets, are carrying problem debt, and are frequent users of third tier credit. It is by these external characteristics that this thesis will define the PB. The next section of this thesis will examine whether it is justified to treat PBs as a unique and separate class of consumer for the purposes of extending them increased protection beyond that of the general consumer when entering a PL SFC.

## SECTION TWO

### **4. The Payday Borrower as a Separate Class of Consumer**

In the previous section of this paper it has been established that PL SFCs are risky credit contracts for any consumers to enter, so consumers ought to be extremely cautious when doing so. It has been shown that the risk of harm is high, and with consumer self-protection skills not being sufficiently adequate and procedural protection narrow, there is a strong justification for legislative consumer credit protection.

In some situations, a consumer will use these credit contracts with the assistance of minimal consumer credit protection and be able to repay them comfortably, without the risk of a debt spiral occurring. However, it is submitted that these consumers are the general consumer who happen to use PL SFCs, as opposed to a PB. This section will argue that there is difference between these general consumers who occasionally use PL SFCs and can comfortably repay them and the PB as a separate and exclusive class of consumer. It is submitted that the PB will not be able to use these credit contracts with minimal legislative protection, but instead will likely experience severe hardship. For this reason the PB requires extended and specific consumer protection, beyond that of the general consumer when using them.

In the previous section it has been established that the PB will be defined by their externally vulnerable characteristics of being financially excluded, having low fixed incomes, having

minimal assets, carrying problem debt, and being frequent users of third tier credit. Although these characteristics place the PB in an externally vulnerable position, it is insufficient on its own to justify treating the PB as a separate class of consumer, as external factors can be rectified. There are however four justifications that will be submitted to treat PBs as a separate class of consumer for the purposes of extending increased consumer protection when entering a PL SFC. These are based on four factors, being the involuntary nature of accepting the contract, the certainty of harm from using the contract, the severity of that harm, and the unavoidableness of the harm.

The first point of difference between the PB and the general consumer is related to their financial exclusion, being their inability to effectively refuse the contract. If a consumer needs a certain item which can only be attained through one particular contract, then they cannot refuse the contract. In this case, even if the consumer was able to discover that the contract did not provide them with their expected benefit, but was instead detrimental to them, they would need to accept the contract regardless. The first problem then is that the consumer has no meaningful choice, and causes them to enter the contract involuntarily.

### **A. No Meaningful Choice**

One assumption of CCT is that the consumer has a choice. This means they do not need *this* particular contract from *this* particular supplier. Instead, if they are not fully satisfied with the contract they will have the choice to not purchase that particular product at all, compromise for a different but similar product, or purchase the same or similar product with a different supplier. In any of these situations the consumer will still be able to exercise choice and have some freedom in contract.

When I entered my third tier loan to repair my car, although I was in a difficult situation and entered it reluctantly, I still entered the contract voluntarily. This is due to the fact that I still had complete freedom in choice to either accept or reject that particular contract,<sup>138</sup> and I also

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<sup>138</sup> Paterson, above n 3, 938 argues that the emphasis placed on the principle of freedom of contract by CCT requires that contractual obligations be voluntarily assumed by contracting parties. The concept of voluntariness, in turn, requires certain preconditions be met before parties can consent to the obligations they

had complete freedom to contract with whichever lender I wanted. Because these conditions were met, I could be expected to accept the full consequences of my choice. However, it could be argued that although no one was forcing me to enter the contract, the choice that was available to me was not a completely legitimate, or meaningful choice.

To assume that a consumer will ultimately always have a degree of choice in regards to the products they contract for is problematic for two reasons. First, to be completely free to reject a contract to purchase an item means the consumer must be in a position to be able to do without the item. This will only then be the case for non-essential items. Where the item is an essential item, the consumer cannot do without the item, so the consumer cannot refuse the contract where it is the only means of obtaining it. Therefore, for complete freedom in contract to exist, it can only be in relation to non-essential items. In order to establish whether there is a meaningful choice for the PB, this part will analysis first whether a third tier line of credit is an essential or non-essential product for the PB. If it can be established that credit is an essential item, a PB confined to third tier credit cannot refuse *a third tier contract for credit*.

Second, having a meaningful choice in choosing a particular supplier will only be present where there is a meaningful difference between the price and terms offered by the different suppliers.<sup>139</sup> Therefore, for there to be a meaningful choice in which lender to choose, there must be a meaningful difference between the PL SFCs. The second section in this part will then analysis a variety of SFCs offered by different payday lenders to establish whether a meaningful difference between the different SFCs exists. If it is found that the terms in most PL SFCs are so similar so as to not create a meaningful difference between the different PLs, then the borrower essentially cannot refuse *the third tier contract for credit*.

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assume in entering into a contract. If a consumer is forced into entering a contract this cannot be said to be voluntary, and therefore the terms under the contract which impose obligations cannot be voluntarily assumed.

<sup>139</sup> Zumbo, above n 79, at 71.

(i) **Credit: A Want or a Need?**

For most products and services, the purpose for which it is obtained will be apparent. When I entered my contract for the purchase of my son's bicycle, it would be apparent that the product was likely for the purpose of a small child to ride. Credit differs from most other products, as the use or purpose for obtaining it is will not be evident unless the consumer offers that information. If I was to enter a contract for a micro loan, it could be that I would also use the money to purchase a bicycle for my son. It is also possible that I could be using the credit to fix my car. It is also equally possible that I was obtaining the funds to pay for almost anything else. This could then include both essential and non-essential items.

Whether a product is essential or non-essential will depend largely on the consequences of not obtaining the product. In my case of purchasing the bicycle, the only consequences of not obtaining it were temporarily disappointing my son and temporarily damaging my pride. Due to these minor consequences, not purchasing a bicycle at all or purchasing a different one would be an available alternative to me in lieu of purchasing that particular bicycle. Therefore, my contract was not for an essential item. I did not need the bicycle. I only wanted it. In the case of entering the loan to fix my car, I could have done without the car being fixed straight away and used alternative means for transport, so again, I did not need the funds. I only wanted them, because I wanted to use my car as my means of transport. However, in my hypothetical situation of requiring emergency funds for my son's essential needs, the product is a need rather than merely a want. This is because where it is identified by the borrower that the purpose for a loan is to purchase household items, and where the borrower is found to not have savings or an alternative source of financial assistance, the stakes are much higher. Due to the consequences of not obtaining the loan then, there is not the option to not contract for it. This type of borrower from my hypothetical situation does not just want the loan, but instead needs it.

Evidence suggests that the purpose for obtaining credit in my hypothetical situation is not a far-fetched, or even unique situation, but in fact typical of the PB in New Zealand.<sup>140</sup> Studies conducted in Australia, the United Kingdom and the United States all also conclude that for the majority of consumers that take out PLs, the borrower believed that the payday loan funds were needed at the time of borrowing. The most common reported reason overall from the combined studies analysed by this paper from New Zealand, the United Kingdom, Australia and the United States for using third tier credit among consumers surveyed was a need for urgent credit to meet the needs of everyday household expenses and essentials.<sup>141</sup>

Wilson's research was able to give many specific examples of what essential household products may consist of. Wilson cited that "for the vast majority of consumers surveyed, PLs are used to cover electricity and gas bills, automotive costs, rent, food and other living expenses".<sup>142</sup> The exact purposes for third tier credit cannot be fully known and logically it will not always be for essentials. However, since evidence suggests that for the majority of PBs the purpose for the credit is to purchase essentials, credit obtained through a PL could then be argued that it ought to be treated as an essential product. Where a consumer does not have savings or an alternative source of financial assistance, as it has been suggested for the majority of PBs, provisions of small amounts of credit will likely be the only means to enable these consumers to meet emergency needs, or smooth consumption when there is a variation in income or expenditure.<sup>143</sup> The practical effects of this then is that for the majority of financially excluded PBs, this type of borrowing is unavoidable, so the credit obtained can thus be regarded as "essential".<sup>144</sup>

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<sup>140</sup> Brunton *Using a third tier lender: experiences of New Zealand*, above n 109, at 7. In this study 75% of borrowers indicated that reason for taking out the loan was to purchase something essential or to make payment on an unexpected bill.

<sup>141</sup> See studies in the United Kingdom at Competition and Markets Authority, Government of the United Kingdom, *Payday Lending market Investigation: Final Report* (24 February 2015); E Kempson and C Whyley, *Kept Out or Opted Out? Understanding and Combating Financial Exclusion* (Policy Press, Bristol, 1999).

In Australia, Treasury, *Review of the Small Amount Credit Contracts Laws: Final Report* (March 2016); North, 'Small Amount Credit Contract Reforms in Australia: Household Survey Evidence and Analysis', above n 67; Wilson, above at n 120; In the United States, Warren and Warren Tyagi, above at n 109.

<sup>142</sup> Wilson, above n 120, at 30.

<sup>143</sup> Chant Link and Associates *A Report on Financial Exclusion Australia* (ANZ, Final Report, November 2004) at 1.

<sup>144</sup> E Kempson, C Whyley, S Collard, J Caskey *In or Out? Financial Exclusion: A literature and research review* (Financial services Authority, Consumer Research 3, July 2000) at 3.116.



Since this product for the typical PB is an essential and there is only one means of obtaining it, the PB will likely recognise their lack of options and know that they will ultimately need to agree to the contract which provides the credit regardless of any other terms they would subsequently become contracted to or the eventual cost of the loan. Therefore, in the case of the typical PB, entering the PL SFC and agreeing to the terms and price is not voluntary. However, even where the financially excluded PB may be forced into using a PL SFC, there is still the argument that the PB has the choice of which PL SFC to use, and hence still ultimately has some freedom of contract.

## **(ii) When They're All the Same**

As has been stated, the PL market is saturated, with 340 lenders currently operating within New Zealand. If a PB is in fact in a situation of needing a PL, they can still exercise their freedom in contract by choosing a PL from amongst the 340 available whose terms and prices are the most favourable to the particular PB's subjective situation. A problem which has been identified in this argument is that for certain products 'there is often no true alternative' between suppliers, as their SFCs will have similar, if not the same, terms and cost.<sup>145</sup>

This thesis submits that this is very much the case for the PL industry. In researching for this paper, 48 SFCs of different PLs operating in New Zealand were examined. Aside from small differences in terms relating to fees and interest, all the SFCs included very similar terms which the borrower was required to agree to in order to secure the credit. This included the WG term which all PL SFCs included, and the total costs of the loans also worked out to be very similar.

In examining the 48 different SFCs, it appeared that the PL industry differs from other industries. In examining such a vast amount of SFCs it would be expected to discover at least some significant difference between the SFCs, as a key factor for most business is developing

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<sup>145</sup> Zumbo, above n 79, 71.

a point of difference from competitors. However, it seems when choosing a PL shopping around is not likely to be of an advantage to the PB like it would normally be.<sup>146</sup>

In most industries, including mainstream credit, suppliers will emerge to specifically cater for a particular type of consumer within the broad customer market. The supplier does this in order to capture that particular niche. However, the PL industry seems to not adhere to this strategy, rendering their product a blunt “one size fits all” product. By refusing as an industry to offer different forms of their product which would better cater for different borrowers and supplying their products under the same or very similar contract terms and price, it can be argued that the entire industry simply offers the same product, or essential one product. Therefore, in the case of the PL industry, freedom to choose a particular PL also becomes redundant. It has been suggested that where there was never another meaningful option other than to enter *that* kind of contract, with *those* kinds of terms, with *that* kind of trader, and at *that* price, the obligations imposed under the terms of the SFC cannot be assumed to be voluntary.

With the first factor submitted that the PB enters the PL without a meaningful choice, this thesis moves to the second factor, being the inevitable harm of the involuntary option.

## **B. The Certainty of the Harm**

The second point of difference between the general consumer and the typical PB is that where for the general consumer a PL may be the right product for them and they may receive the benefit from the contract that they had expected, for the PB as a class of consumer the PL is never the right product and the PB will never receive their expected benefit. For these consumers the PL is certain harm.

As established, consumers enter deals with the expectation that the deal will bring them some form and degree of benefit. Ultimately, the PB wants what all consumers want, which is to

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<sup>146</sup> Brunton, at n 109, at 13.

attain the ‘right’ product at the ‘right’ price, which will solve their problem and improve their situation. Specifically, what they want is a line of credit which is affordable to them, and will not cause them hardship to repay. Ideally, this means a line of credit with low interest, as they typically have low income, to be paid over a reasonable and realistic period of time for them. At the same time however, the PB also wants a line of credit which they can pay back quickly, so as to be out of debt quicker. The PL however does not ever achieve this for the PB. In fact, the PL achieves the opposite for this consumer, being an expensive line of credit, to be paid over an unreasonable and unrealistic period of time for them, which keeps them in debt for longer than they intended. It the wrong product for this consumer, and the whole PL industry is modelled and thrives on offering the PB the wrong product.

### **(i) Problem Debt**

Often prior to the PB entering the PL SFC, the PB will have already acquired debt, causing them to be reliant on lenders. The purpose of the payday lender offering credit is to increase the borrower’s debt and decrease their ability to comfortably repay their debt. Essentially, the PL’s goal is to increase the PB’s reliance on the payday lender by increasing their hardship with problem debt.

Repaying debt will naturally result in otherwise available funds being reduced. However, repaying debt does not directly correlate to hardship. Most New Zealand families are in some form of debt, with mortgage debt alone making up approximately 80% of New Zealand consumer debt,<sup>147</sup> and can be considered ‘normal’ debt to carry for a home-owner. Debt can be defined as: “any financial obligation, leveraged against an asset or against future income”,<sup>148</sup> and will often be a necessity for adult life. For most, although from time to time there may be some financial strain, overall they will manage the debt well. Where debt moves from manageable, or normal debt, to unmanageable, or problem debt, has been described as a level of debt exceeding the individual’s capacity to reasonably service it.<sup>149</sup> For many PBs, their

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<sup>147</sup> Families Commission & Retirement Commission (2008). Beyond Reasonable Debt – Part I: A background report on the indebtedness of New Zealand families.

<sup>148</sup> Families Commission (2008) Ibid, at 47.

<sup>149</sup> Families Commission & Retirement Commission (2009a). Escaping the Debt Trap: Experiences of New Zealand families accessing budgeting services. Wellington: Families Commission, at 6.

problem debt stems from lacking sufficient income to cover their household expenses. This then turns to spiralling debt, or initial debt leading to other debts.<sup>150</sup>

Where the PL industry argue that they provide a valuable service to consumers abandoned in the credit market, Malbon suggests that providing these expensive short-term loans to deal with financial hardship for a typical PB is like ‘providing an alcoholic whisky to deal with a hangover’.<sup>151</sup> Although it may offer temporary relief from financial hardship, long term it will exacerbate the problem rendering the PB more financial vulnerable, rather than more financial stable as the industry claims. Whatever the stage of hardship the PB was experiencing prior to entering the PL, research and empirical studies conducted in New Zealand and in various overseas jurisdictions conclude that the majority of PBs could not afford their loans, and once the loan had been taken out they were in a worse off position and their level of hardship increased.<sup>152</sup>

The Competition and Markets Authority in the United Kingdom found through surveys conducted in 2015 that 35% of the borrowers of PLs could not afford to take out their loans and had subsequently missed their payments on the loans.<sup>153</sup> The Bristol University study also showed that a quarter of PBs acknowledged that taking out the payday loan had made their financial situation worse due to not being able to afford the loan,<sup>154</sup> while two thirds thought that PLs had trapped them into a cycle of borrowing.<sup>155</sup> This statistic further suggests that these borrowers are extremely vulnerable, as many are not even able to recognise the connection between a cycle of borrowing and financial hardship until they are caught in it. A further survey of PBs conducted by the consumer organisation Which, found that nearly half of these

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<sup>150</sup> The Families Commission report (2009b), *Ibid*, at 7-8.

<sup>151</sup> Malbon, above n 88, at 240.

<sup>152</sup> The Financial Counselling Report, above at n 103, found that 92% of the people seeking financial counselling had used multiple payday loans in the past 12 months. 79% of these counsellors had reported that a significant cause of their client’s financial hardship was due to resorting to payday loans, and that they had not at all improved their client’s situation at all. The Caught Short Report found that those who used payday lenders were very rarely one off users, but in fact most users were repeat, frequent users. 40% of payday loan users have repeat patterns of use, showing a form of dependence on them. These 40% will take out another payday loan as soon as the previous one is paid. See also Wilson, above at n 120; See also University of Bristol, above at n 134; See also Brunton, above at n 109; See also Chin, above at n 31, at 103.

<sup>153</sup> Competition and Markets Authority, Government of the United Kingdom, *Payday Lending market Investigation: Final Report* (24 February 2015), at 4.

<sup>154</sup> University of Bristol, above at n 134, at 77.

<sup>155</sup> University of Bristol, *Ibid*, at 78.

borrowers could not afford the payments on their PLs and that over half of the borrowers had actually missed a payment on a PL in the last year.<sup>156</sup>

## (ii) **Debt Spirals**

A common result amongst PBs not being able to comfortably repay their loan is the need to roll the loan over. The study conducted by Which showed that nearly half of the borrowers after defaulting on their first loans had resorted to rolling over the initial loan, and this had led to the start of a debt spiral.<sup>157</sup> Another option taken by borrowers closely related to rolling over the initial loan is the use of multiple loans. The Bristol university study showed that in the United Kingdom, in addition to short term loans usually being taken for the purposes of household consumptive purposes,<sup>158</sup> when this is the purpose of the loan the borrowers are 4 times more likely to not be able to make the loan payments in time and are forced to take out multiple loans or roll the initial loan over.<sup>159</sup> Debt charity, Step Change, also have concluded from studies conducted that borrowers who use credit to fund the basic costs of living are more likely to have multiple loans.<sup>160</sup> The result of this is that many PBs find themselves in a situation where they are constantly financing an outstanding high interest loan. It has been found that where this is the case, at some stage these borrowers will fall victim to substantial financial hardship which leads to a debt spiral.<sup>161</sup> The Bristol University study also found a correlation between regular use of payday loans to purchase household items and financial hardship leading to debt spirals.<sup>162</sup>

The reason for the inevitable link between resorting to PLs to pay for household goods and financial hardship and debt spirals is that a large proportion of the PB's low weekly income is

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<sup>156</sup> 44 <http://press.which.co.uk/whichstatements/half-of-people-taking-out-payday-loans-cannot-afford-to-pay-them-back/> (10 December 2013) and <http://press.which.co.uk/whichstatements/which-response-to-payday-lenders/> (10 December 2013)

<sup>157</sup> Which, 'Credit Britain: Making Lending Work for Consumers' (Research Report, May 2013), at 18.

<sup>158</sup> University of Bristol, above at n 134, at 19 and 112.

<sup>159</sup> Ibid, at 70.

<sup>160</sup> Step Change, 'Briefing Document: High Cost Credit Bill Second Reading, House of Commons' (12 July 2013); Financial Conduct Authority, 'Consultation Paper CP 13/10: Detailed Proposals for the FCA Regime for Consumer Credit' (October 2013).

<sup>161</sup> M. Burton, 'Keeping the Plates Spinning: Perceptions of Payday Loans in Great Britain' (Consumer Focus Research Report, August 2010), above at n 132, at 21.

<sup>162</sup> University of Bristol, above at n 134, at 68.

being used to simply pay interest on loans. If a PB is struggling to pay for household essentials without the added burden of a high interest loan, it follows that their situation will be substantially more difficult with it. It is logical then that the borrower will have little choice but to continue to resort to more PLs to cover the living expenses of the weeks to come. This leaves no choice but to continue to live with high interest debt while the PB's living conditions and situation continues to deteriorate. The next part of this section will examine the actual practical harm caused by the PB's certain to deteriorate situation, the victims of the harm, and the severity of the harm.

### **C. The Severity of the Harm**

The third point of difference between the general consumer and the typical PB is that the harm which the typical PB endures is more severe and has often unrecognised victims.

It has been established that the typical PB to varying degrees has difficulty on a weekly basis to pay for essential household items. For the large percentage of PBs who are forced to roll over their loans or continue to take out regular loans, the available funds needed to purchase essential household items reduces further due to the repayments on the principle and interest on the outstanding PLs. Over time, the result of this is that often for some borrowers in these situations some essential goods and services will need to be sacrificed, reduced, or replaced with alternative and inferior goods and services. Consumers living in circumstances where basic essential household goods and services are frequently unattainable to them is a common trait with consumers living in inadequate living standards.

It has also been established that often the typical PB will be responsible for the care of several dependent children. Where the borrower is forced to sacrifice their essential items due to third tier debt, it is also the borrower's dependent children often sacrificing essential items also, as the lifestyle and well-being of children is closely bound up with the lifestyle and well-being of the parents.<sup>163</sup> These essential items being sacrificed can range from clothing, nutritious food,

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<sup>163</sup> Dale, M. C., M. O'Brien and S. St John (2011). Left further behind: how policies fail the poorest children in New Zealand. Auckland, Child Poverty Action Group, at 9.

healthcare, and educational resources.<sup>164</sup> Sacrificing such items can lead to inadequate living standards for children, which can lead to unacceptable hardships, compromising the children's present and future wellbeing.

### **(i) The Under-recognised Victims**

Children have long been a paramount concern within New Zealand. It has been recognised that children only have one chance to grow and develop, so the resources and opportunities which they receive as children are critical to them as children, and also affect their adult lives. Since children cannot alter or control the resources or opportunities they receive, they are completely dependent upon others, being adults, parents and the wider society for these. This places them in an extremely vulnerable position which requires and deserves protection. Children have the right to a stable, happy, safe, secure and fulfilling life, so where an obstacle that presents a possible danger to this can be identified, it ought to be addressed.

In analysing third tier debt as a social hazard where children are the under recognised victims of inadequate living standards, it is necessary to define an adequate living standard. In defining an adequate living standard, one approach is to consider the term poverty, which is closely associated with inadequate living standards. Research in 2011 by the Child Poverty Action Group (CPAG),<sup>165</sup> and Every Child Counts,<sup>166</sup> and in 2012 by the Children's Commissioner's Expert Advisor Group on Solutions to Child Poverty<sup>167</sup> found that in New Zealand approximately 270,000 or 25% of children live in poverty. With the increasing number of children in New Zealand living in poverty and the increasing number of their parents carrying chronic third tier debt, a direct connection has been established between the two, which has attracted the concern of CPAG.

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<sup>164</sup> Dale, M. C. (2014). New Zealand's debt society and child poverty: Child Poverty Action Group Background Paper, Child Poverty Action Group, at 4.

<sup>165</sup> Dale, M. C., M. O'Brien and S. St John (2011). Left further behind: above at n 162.

<sup>166</sup> Henare, M., A. Puckey, A. Nicholson, Dale, M.C and R. Vaithianathan (2011). He Ara Hou: Getting it right for Aotearoa New Zealand's Maori and Pasifika children. Auckland, Every Child Counts. [http://www.everychildcounts.org.nz/\\_w/wpcontent/uploads/2010/06/He-Ara-Hou-Report-20112.pdf](http://www.everychildcounts.org.nz/_w/wpcontent/uploads/2010/06/He-Ara-Hou-Report-20112.pdf)

<sup>167</sup> Expert Advisory Group (2012). Solutions To Child Poverty in New Zealand: Evidence for Action. Wellington, Children's Commissioner.

In New Zealand, the poverty line threshold is defined as living below 60% of the median disposable household income adjusted for family size, after housing costs.<sup>168</sup> Part of the reason for this high poverty percent can be attributed to New Zealand becoming an increasingly unequal society in regards to the gap between average incomes and median or mid-point incomes. Although this poverty line is useful in application for its certainty, it has been criticised for usefulness. The reasons for the criticism is first, how housing costs are considered within the poverty line. Within the current poverty line, figures are reported after housing costs, which is calculated by deducting 25% from the corresponding 'before housing costs' threshold as an allowance for housing costs.<sup>169</sup> The problem identified with this is that in reality, housing costs, especially in the main centres, tend to be closer to 33%. This means that the true funds available to purchase essential household items is significantly less than reported. This leads to an inadequate indication of hardship.<sup>170</sup>

The second criticism is that low income does not necessarily correlate to an inadequate living standard, which is normally associated with poverty. Low disposable income however *can* lead to hardship. It has been identified that a growing number of families at the bottom end of the median disposable income experience financial distress from their fixed low incomes not rising in proportion to their costs of food, utilities and rents.<sup>171</sup> The New Zealand Council of Christian Social Services' Vulnerability Report<sup>172</sup> notes that, between March 2009 and March 2011, food prices overall increased by 6%, where average hourly earnings only increased by 3.4%, which in itself caused a spike in families experiencing desperation and turning to third tier debt to compensate for the shortfall.

Therefore, although income is an important aspect, it is only one aspect of living in poverty. Basing poverty on income levels is very limiting in determining access to funds required to

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<sup>168</sup> Perry, B. (2013). Household Incomes in New Zealand: trends in indicators of inequality and hardship 1982 to 2012. Wellington, Ministry of Social Development.

<sup>169</sup> Perry, B. (2011). Household Incomes in New Zealand: Trends in Indicators of Inequality and Hardship 1982 to 2010. Wellington: Ministry of Social Development, at 162.

<sup>170</sup> Dale, M. C., M. O'Brien and S. St John (2011), above at n 163, at 15.

<sup>171</sup> Rashbrooke, M., Ed. (2013). Inequality. A New Zealand Crisis. Wellington, BridgetWilliams Books.

<sup>172</sup> New Zealand Council of Christian Social Services (NZCCSS). (2011). Vulnerability Report Issue 9, June 2011. Wellington: New Zealand Council of Christian Social Services



purchase essential items, as simply increasing an individual's income will not necessarily mean they will have the ability to maintain comfortable living standards. A different approach is to consider wealth inequality, which refers to the spread and distribution of income and wealth. Measures of inequality provide a picture of the position of different groups in society and the relationships between those who have the most and those with the least. Wealth inequality is more marked than median income and is very pronounced in New Zealand. Studies show that in New Zealand the top 1% of wealthy individuals own 16.4% of total net worth, where the bottom half of the population collectively own only 5.2% of total net worth.<sup>173</sup>

The significance of inequality in this context is that there is a stronger relationship between inequality and inadequate living conditions for children than parental income. It has been found that countries with lower levels of inequality demonstrate higher levels of overall child well-being and lower levels of child poverty.<sup>174</sup> Ridge and Wright argue that poverty and child hardship is inextricably linked to inequality, and that it is not just about material, social and economic resource, but also about social relationships, social process and the control and exercise of power. Therefore, hardship developed by poverty from inequality derives from disadvantage, rather than simply being below the average income.<sup>175</sup> If there is a severe lack of resources, essential social, material and economic needs cannot be met. In rich countries like New Zealand however, the concern is not about absolute deprivation, but about a lack of resources that prevents full participation in society and a sense of being socially included. In New Zealand, the Ministry of Social Development reflects the relative poverty approach: Poverty in the richer nations is about relative disadvantage. It is about households and individuals who have a day-to-day standard of living or access to resources that fall below a minimum acceptable community standard.<sup>176</sup>

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<sup>173</sup> Cheung, J. (2007). Wealth Disparities in New Zealand. Paper presented at the Social Policy, Research and Evaluation Conference. Retrieved from [www.stats.govt.nz/sofie](http://www.stats.govt.nz/sofie), at 7-8.

<sup>174</sup> Hertzman, C., Siddiqi, A., Hertzman, E., Irwin, L. G., Vaghri, Z., Houweling, T., et al. (2010). Bucking the inequality gradient through early child development. *British Medical Journal*, 340, at 468.

<sup>175</sup> Ridge and Wright (2008), at 4. Ridge, T., & Wright, S. (Eds.). (2008). *Understanding Inequality, Poverty and Wealth: Policies and Prospects*. Bristol: Policy Press, at 4.

<sup>176</sup> Perry, B. (2009). *Household incomes in New Zealand: trends in indicators of inequality and hardship 1982 to 2008*. Wellington: Ministry of Social Development, at 5.

In recognition of this, a living standards approach has been developed to measure a number of other important components of living standards. Although it is difficult to find a precise measure for an adequate and acceptable standard of living, the Living Standards reports from the Ministry of Social Development attempts to provide a basis for establishing such a measure in New Zealand.<sup>177</sup> The Economic Living Standards Index covers the full spectrum of material well-being from low to high living standards and is based around four components: ownership of goods; extent of economising; participation in social life; and a self-rating.<sup>178</sup> This has been found to be a better indicator of New Zealanders living in hardship than simply focussing on income.

In 2008, using the Economic Living Standards Index, it was found that children were the worst effected group, with 19% of children living in serious or significant hardship.<sup>179</sup> 39% of these poorest children in New Zealand are found disproportionately in sole parent households.<sup>180</sup> Another common trait of these children living in hardship is that their parents, parent, or care-giver carry chronic problem debt,<sup>181</sup> which gives a clear indication of the correlation between child hardship and the biggest contributor of chronic debt amongst low income families, being third tier debt.

Although payday lending cannot be blamed as the cause of inadequate living standards for children, it can be concluded to be an attributing factor in keeping children in poverty for longer, worsening the severity of the poverty, and worsening the effects on the children.<sup>182</sup>

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<sup>177</sup> Jensen, J., Sathiyandra, S., & Matangi-Want, M. (2007). The 2004 New Zealand Living Standards Survey: What Does it Signal about the Importance of Multiple Disadvantage? *Social Policy Journal of New Zealand*(30), 110-144.

<sup>178</sup> Perry, B. (2009). Household incomes in New Zealand: trends in indicators of inequality and hardship 1982 to 2008. Wellington: Ministry of Social Development, at 50.

<sup>179</sup> Perry, (2009), *Ibid*, at 50.

<sup>180</sup> Perry, (2009), *Ibid*, at 50.

<sup>181</sup> Perry, (2009), *Ibid*, at 50.

<sup>182</sup> Malbon explains that payday lenders do not create the problems of poverty and financial exclusion, but it can be blamed for compounded poverty, which undermines social cohesion and makes a mockery of antipoverty policies. See Malbon, at n 88, at 239-40.

## **(ii) The Effects of Child Poverty**

There have been various ways identified of how third tier debt enabling poverty adversely affects children's well-being. The first of these is physical health. Poverty is one of the leading factors contributing to illness, disease, disability and deaths in New Zealand children. For children, poverty means lacking the material resources to receive regular health care, receive nutritious food, and obtain adequate housing.

In New Zealand, children growing up in poverty experience significantly poorer physical health than other children across a wide range of health measures, including infant mortality and hospital admissions for infectious and respiratory diseases, as well as increased risk of longer-term negative health problems like poor dental health.<sup>183</sup> Examples of poverty-related child illnesses potentially avoidable through early access to effective treatment in primary health care include, asthma, bronchiectasis, skin infections, dental decay, dermatitis and eczema, gastro-oesophageal reflux, nutritional deficiency, bacterial pneumonia, rheumatic fever, otitis media, acute upper respiratory tract infections, vaccine-preventable diseases, and urinary tract infections.<sup>184</sup> It has been found that for rheumatic fever and bronchiectasis, which are diseases particularly highly associated with poverty and easily preventable, New Zealand has some of the worst health statistics for children in the OECD.<sup>185</sup>

Nutritional healthy food in sufficient quantities each day is also essential for good health and well-being. It both helps to prevent immediate sickness and infections, as well as prevent or reduce future physical health problems. In 2019, a study conducted by the University of Otago measured the average cost of providing adequate food for children based on the Ministry of Health's guidelines. Over three age groups of children, the study found that the average annual cost of food from supermarkets for one 5 year old child was approximately \$2,500 per year,

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<sup>183</sup> Craig, E., Jackson, C., Han, D., & NZCYES Steering Committee. (2007). *Monitoring the Health of New Zealand Children and Young People: Indicator Handbook* Auckland: Paediatric Society of New Zealand and the New Zealand Child and Youth Epidemiology Service

<sup>184</sup> Craig, E., Taufa, S., Jackson, C., & Han, D. Y. (2008). *The Health of Pacific Children and Young People in New Zealand*. Auckland: Paediatric Society New Zealand, University of Auckland/ Uniservices, at 126.

<sup>185</sup> The Children's Social Health Monitor (2012) *The Children's Social Health Monitor 2012 Update*. DOI: [http://www.nzchildren.co.nz/children\\_reliant.php](http://www.nzchildren.co.nz/children_reliant.php)

where a 10 year old cost \$3,500, and an adolescent was \$5,500.<sup>186</sup> Where food is regularly purchased using third tier credit, this amount will be considerably more, as purchasing food using third tier credit essentially increases the price of food. When considering the total average cost for a low income household per year for raising a child under 12 years is \$7,500 (21% of annual income) and a child between 12 and 18 is \$10,000 (28% of annual income), the food component becomes a high proportion of the parent's child-related annual expenditure.<sup>187</sup> Where tight budgets are further squeezed regularly by escalating debt repayments, there is a high risk, particularly for teenagers, to not receive adequately nutritious food.

It has been found that families repaying third tier debt while living below the poverty line tend to accept sub-standard and crowded housing conditions, which can also compromise children's present and future physical health.<sup>188</sup> In regards to sub-standard quality houses, cold, un-insulated houses have been found to have adverse effects on children's health<sup>189</sup> and contribute to a high amount of particularly respiratory related preventable diseases in children.<sup>190</sup> Since cold damp homes can cost a lot to heat, the heating costs can be unaffordable for low-income families, resulting in children living in cold damp conditions, which often lead to sicknesses like colds and flu.<sup>191</sup>

In addition to accepting sub-quality housing, the second way low-income families tend to reduce their costs of rent is by sharing their living space. This leads to the second danger in

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<sup>186</sup> Information Package for Users of the New Zealand Estimated Food Costs 2019: Information collected by the Department of Human, University of Otago, at 8.

<sup>187</sup> *Costs of raising children*, by Iris Claus, Geoff Leggett and Xin Wang which was presented at the New Zealand Association of Economists' 2009 conference in July 2009.

<sup>188</sup> Dale, M. C., M. O'Brien and S. St John (2011). Left further behind: above at n 163, at 137.

<sup>189</sup> Lennon, D. (2013) Our future wasted. The New Zealand Herald, 19 May DOI: [http://www.nzherald.co.nz/nz/news/article.cfm?c\\_id=1&objectid=10884536](http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=10884536)

<sup>190</sup> Turner, N., I. Asher, K. Bach, S. Denny, N. Fancourt and S. Merry (2011). Child Health and Poverty. Left Further Behind. M. Dale, M. O'Brien and S. St John. Auckland, Child Poverty Action Group Inc

<sup>191</sup> Housing research led from Wellington showed that in seven low-income areas in New Zealand insulating houses significantly improved self-rated health, reduced self-reported wheezing, days off school and work, and visits to general practitioners as well as showing a trend for fewer hospital admissions for respiratory conditions. See Howden-Chapman, P., Pierse, N., Nicholls, S., Gillespie-Bennett, J., Viggers, H., Cunningham, M., et al. (2008). Effects of improved home heating on asthma in community dwelling children: randomised controlled trial. *BMJ*, 337, a1411. In the Counties Manukau region of Auckland, a Healthy Housing programme which involved improving housing conditions resulted in a 27% lower rate of housing-related potentially avoidable hospitalisations for 5 to 34 year olds in that area. See Jackson, G., Thornley, S., Woolston, J., Papa, D., Bernacchi, A., & Moore, T. (2011b). Reduced acute hospitalisation with the healthy housing programme. *J Epidemiol Community Health*

sub-standard housing, being over-crowding. Contact with infectious organisms is likely to be higher in overcrowded housing conditions as there is more risk for contact with other sick people. Household crowding has in fact been found to be the strongest risk factor for meningococcal disease.<sup>192</sup> Another danger here is limited washing facilities and the likelihood of sharing linen and towels, which reduces good hygiene and increases the risk of germ related illness.

In addition to the present harm sacrificing essential goods and services can have on children, children's future wellbeing can also be severely adversely affected. Children from low income families are less likely to succeed educationally than children from high income families. The link between parents' socioeconomic status and a child's educational outcome is very high in New Zealand when compared internationally. This is possibly due to the indirect costs of education being proportionally very costly to low income families in New Zealand. High rents placing strain on low incomes also exacerbate mobility, meaning many children move frequently and attend a number of different schools. This can compromise their education, as well as social networks and sense of community.<sup>193</sup> Not succeeding educationally can reduce the opportunities significantly for children when they become adolescents and adults, effecting future income and quality of life.

In addition to children's physical health which can be adversely affected from living in inadequate living standards, children's mental health is also at risk, and some aspects of this can cause deep and long-lasting harm. Non-material adverse aspects of poverty emerge from everyday interactions with wider society and from the way people in poverty are talked about and treated. These can include lack of voice, disrespect, humiliation, loss of self-esteem, shame

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<sup>192</sup> Baker, M., McNicholas, A., Garrett, N., Jones, N., Stewart, J., Koberstein, V., et al. (2000). Household crowding a major risk factor for epidemic meningococcal disease in Auckland children. *Pediatr Infect Dis J*, 19(10), 983-990. It has been noted that the research conducted in this research was a turning point in New Zealand for starting to change housing policies for the better and stimulating more housing research.

<sup>193</sup> Carroll, P., S. Casswell, J. Huakau, P. Howden-Chapman and P. Perry (2011). "The widening gap: Perceptions of poverty and income inequalities and implications for health and social outcomes." *Social Policy Journal of New Zealand* 37, at111- 122.

and stigma.<sup>194</sup> All these aspects of poverty have been found to be compounded for children living in poverty and can diminish self-worth and confidence as the child grows into adulthood.

As established, problem debt leading to poverty can have adverse effects on children and can be very far-reaching. One far reaching effect stems from the increased strain third tier chronic debt has on family relationships. The stresses, lack of choices and anxiety from struggling financially present considerable challenges for families raising children, and this can effect parental ability to respond appropriately to children.<sup>195</sup> Since high stress naturally can make people more irritable, the chances of a parent responding angrily, insensitively or inappropriately to a crying baby or frustrated toddler are increased. With this, there is an increased risk of emotional or mental harm to the child.

Research over the last few decades has shown that addressing the social and emotional needs of children is fundamentally important. From the time of their birth, children need social interaction from caretakers who are able to respond to their needs with sensitivity. It has been found that parents and care-takers who do respond sensitively to these needs and provide emotionally warm and supportive environments, lay the foundations for later social and emotional competence which provides children with a greater chance to develop into adolescents and adults who are empathic, socially competent, and better able to regulate their own emotions.<sup>196</sup> Conversely, those who grow up in environments where these emotional needs are not met, or where they are traumatised by angry and impatient responses, are at risk of developing both immediate and future mental health problems. It has been found that minor mental harm to children tend to compound as the child grows older, leading to an increased risk of the child developing conduct disorder, depression, anxiety, substance abuse and self-harm in adolescence and into adulthood.<sup>197</sup>

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<sup>194</sup> A group of low income parents in the UK told a parliamentary group, 'the worst thing about living in poverty is the way it gives others permission to treat you – as if you don't matter'. See Lister, R. (2010). The 2010 Samell Oration. Towards the inclusive society: Brotherhood of St Laurence Melbourne.

<sup>195</sup> Besharov, D., & Laumann, L. (1997). Don't call it child abuse if it's really poverty. *Journal of Children and Poverty*, 3(1), at 5-36.

<sup>196</sup> Shonkoff, J. P., & Phillips, D. A. (Eds.). (2000). *From Neurons to Neighborhoods: The Science of Early Childhood Development*. Washington DC: National Academy Press.

<sup>197</sup> Dube, S. R., Felitti, V. J., Giles, W. H., & Anda, R. F. (2003). The impact of adverse childhood experiences on health problems: evidence from four birth cohorts dating back to 1900. *Preventive Medicine*, 37(3), 268-277.; See also, Poulton, R., Caspi, A., Milne, B. J., Thomson, W. M., Taylor, A., Sears, M. R., et al. (2002). Association

In addition to financial stresses increasing the risk of inadequate emotional support from parents, it has been found that it can also increase the risk of physical and mental abuse. An OECD report in 2011 on the well-being of children revealed evidence “suggestive of at least some linkage between economic domains and child maltreatment at a country level”.<sup>198</sup> More broadly, the report stated that there is considerable evidence that poverty is significantly correlated with child abuse and neglect.<sup>199</sup> It is suggested that the link between the two might come from the ways in which low income restricts ability to meet children’s basic needs, parental stress and depression, and a smaller number of disciplinary options because of lack of financial resources.<sup>200</sup> Internationally there is vast evidence documented on the correlation between poverty and child abuse. Some sources sight poverty as a main factor,<sup>201</sup> where others sight it as the single best predictor of child abuse and neglect,<sup>202</sup> particularly when the abuse involves severe violence.<sup>203</sup> There is no evidence to suggest however that the more poverty stricken a parent, the greater the risk of child abuse, or the greater the severity. However, it does seem the more common type of abuse is in the form of neglect.

Since the wide definition of child abuse consists of anything which individuals, institutions, or processes do or fail to do which directly or indirectly harms children or damages their prospects for safe and healthy development into adulthood, this would indicate that poverty, arising from whatever cause, including third tier chronic debt, in itself constitutes a form of abuse in that it represents a failure to ensure that children are given and provided with the resources and opportunities to develop fully.<sup>204</sup>

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between children’s experience of socioeconomic disadvantage and adult health: a life-course study. *Lancet*, 360(9346), 1640-1645.; See also, Boden, J. M., Fergusson, D. M., & Horwood, L., J. (2010). Risk factors for conduct disorder and oppositional/defiant disorder: evidence from a New Zealand birth cohort. *Journal of the American Academy of Child & Adolescent Psychiatry*, 49(11), 1125-1133.

<sup>198</sup> OECD. (2011). *Doing Better for Families*. Paris: Organisation for Economic Co-operation and Development, at 251.

<sup>199</sup> OECD (2011), *Ibid*, at 253

<sup>200</sup> OECD (2011), *Ibid* at 253.

<sup>201</sup> Frederick, J., & Goddard, C. (2007). Exploring the Relationship Between Poverty, Childhood Adversity and Child Abuse from the Perspective of Adulthood Child Abuse Review, 16, at 324. See also, National Society for the Prevention of Cruelty to Children. (2008). *Poverty and Child Maltreatment*.

<sup>202</sup> [www.exmaxhealth.com](http://www.exmaxhealth.com)

<sup>203</sup> Gelles, R. J. (1992). Poverty and Violence Towards Children. *American Behavioural Scientist*, 35(1), at 263.

<sup>204</sup> Quilgars, D. (2001). Child Abuse. In J. Bradshaw (Ed.), *Poverty: the outcomes for children*. London: Family Policy Studies Centre.

In tackling poverty, the CPAG has advised that it requires a commitment from the Government to make children the highest priority.<sup>205</sup> If children are going to remain the most hard-hit victims of the payday lending industry, then the government ought to take the OECD's advice and take a stronger policy focus on the link between problem debt and child poverty.<sup>206</sup> Without such an approach, it is likely children will continue to suffer unnecessarily in New Zealand.

With the certainty of harm confirmed and the severity of it revealed when the typical PB enters a PL SFC, this section now turns to the unavoidableness of the harm.

## **D. The Unavoidable Harm**

The fourth point of difference between the general consumer and the typical PB is that the general consumer has the ability to avoid the harm, where the PB does not. It has been established that the PB is often in a difficult situation prior to entering the PL SFC, however simply being in a bad, or even desperate situation, in itself does not necessarily merit special treatment or is justification to be placed in a separate category of consumer. This is because the general consumer will also from time to time find themselves in unfavourable, difficult, or even vulnerable circumstances due to unfortunate external factors. Despite these unfortunate external factors however, the general consumer will still be expected to exercise a certain level of self-protection skills within the market place when entering contracts and making financial decisions so as to avoid increasing their harm. If the general consumer does not, then they may also experience similar detriment as the PB. The crucial difference is that the general consumer has the ability to avoid this harm through either using, or upgrading their self-protection skills. It is submitted that the PB however does not have, and is not able to achieve, sufficient self-protection skills to avoid the certain and severe harm which the PL SFC presents to them. The reason for this is because the PB as a class of consumer is a part of an unfair system which they

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<sup>205</sup> Dale, M. C., M. O'Brien and S. St John (2011). Left further behind: above at n 163, at 3.

<sup>206</sup> Sharpe, N. (2011). Health equity: a prerequisite for social and economic progress. The New Zealand Medical Journal, 124(1330), at 1-3.



are unable to break away from and unable to avoid. This unfair system comprises of three factors, being a vulnerable position, an inevitable problem, and an inability to recover.

### (i) **The Internal Vulnerability**

The first factor of the unfair system is the PB's vulnerable position. It has been extensively established in this paper that the PB is a vulnerable consumer due to external factors. However, as has also been established, the general consumer can also experience vulnerability from external factors, but that external vulnerability does not necessarily equate to an inability to make sensible and logical decisions. Internal vulnerability on the other hand, is not derived from external factors, but is inherent. This type of vulnerability is attached to the PB regardless of their circumstances, and is the inherent tendency to make poor financial decisions.

One way in which PBs routinely exercise poor financial skills is not allocating sufficient importance to price. For the general consumer, price will usually be of significant importance when interacting in the marketplace. Many consumer protection laws in New Zealand and in overseas jurisdictions are in place with the expectation that consumers will pay close attention to price, and for the general consumer, they will, as it is in their nature to do so. It has been found that identifying and searching for price becomes natural for the general consumer due to life-learned self-protection mechanisms developed specifically for the purpose of protecting the consumer from deception in the marketplace.<sup>207</sup> The entire marketplace survives on persuasion, whether it is advertising, sales techniques, or business structure, so all consumers are consumers of marketplace persuasion. It is the inherent goal of the general consumer to become

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<sup>207</sup> It has been suggested that these self-protection mechanisms derive from the average general consumer's natural suspicion of suppliers attempting to mislead them. Boush D M, Friestad, M and Wright, P *Deception in the marketplace* (Routledge, New York, 2009), at 96.

The general consumer will also naturally feel uncertain when being persuaded to pay a portion of money in exchange for a good or service and this will increase the complexity of the average general consumer's thinking. Y Schul, R Mayo, E Burnstein and N Yahalom 'How people cope with uncertainty due to chance or deception' (2007) *Journal of Experimental Social Psychology*, 43(1), 91-103.

a skilled consumer of persuasive messages, and skilled persuasive consumption is instrumental to successful product consumption.<sup>208</sup>

Marketplace deception protection skills involve component skills in detecting deception in specific situations, neutralising the effects of that deception and resisting the deception.<sup>209</sup> This skilful persuasive consumption is developed through experiences, beginning in early adolescence and continuing over a lifespan. The required experiences to build this skill are gained from the individual's social environment and formal or informal coaching. As a result of this, each individual will have different levels of deception protection skills depending on their social standing, exposure to experiences, and access to resources. Due to this, for one individual it may take them until they are well into their adult years to have developed the basic necessary protection skills that another individual was able to develop as early as a teenager. In extreme cases, some individuals may never develop basic protection skills if they did not gain enough of the essential experiences from an early enough age.

For the competent consumer of market persuasion, they will learn from each of their new experiences and incrementally build on them to not only continuously protect themselves better from new and different forms of deception in the marketplace, but also further develop their self-regulated defensive mechanisms for the forms of deception they have encountered in the past. This is done through continuous use of their skills, which guides the consumer to achieving a multitude of different goals over time and across changing circumstances and contexts. Not only this, but it also enables the consumer to achieve these wide range of goals more safely,<sup>210</sup> including making increasingly complex purchases, entering deals, entering contracts and organising finances. This leads to the general consumer being in the position to pursue their goals unassisted and grants them independence, which naturally then leads to the skill of wise purchase decision-making within the consumer world.<sup>211</sup> This is a needed skill, because as the general consumer advances through life, their situation and purchases will inevitable become more complicated, more susceptible to deception, and the consequences of

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<sup>208</sup> M Friestad and P Wright, "The persuasion knowledge module: how people cope with persuasion attempts" (1994) *Journal of Consumer Research* 21 at 1-31.

<sup>209</sup> Boush, *Deception in the Marketplace* above, at n 207, at 143.

<sup>210</sup> Boush, *Deception in the Marketplace*, *Ibid*, at 139.

<sup>211</sup> Boush, *Deception in the Marketplace*: *Ibid*, at 32.

bad financial decisions more severe. Examples of this are purchasing homes, starting businesses and acquiring large amounts of debt.

When the consumer begins behaving in this way from an early age, they gain their independence in the marketplace early. This leads over time to prolonged circumstances of being in the position to choose. It has been found that having the ability to choose early and frequently having the ability to make independent financial decisions leads to the learnt behaviour of accepting the consequences of choice, which then moulds the consumer to grow to be increasingly financially responsible over their entire life.<sup>212</sup>

As the consumer moves through this process, they will early on understand and accept that once a price has been fairly disclosed and identified, the responsibility to adequately use that identified price to protect their best interests is fully on them. In doing this they will naturally go to effort to thoroughly and correctly identify a price and use it for comparison. In effect, the price of a good or service will then automatically become a salient factor when making all purchases. This salient feature of price is also present for the general consumer when obtaining credit or acquiring debt.

Large proportions of general consumers regularly take on large amounts of debt, whether it is a mortgage, student loan, car loan, credit cards, or even a short term loan like a PL. Most general consumers however do not enter debt spirals. They instead are able to comfortably make the repayments on their loans from having planned ahead and being aware of what the total cost of the loan will eventually be. This is done by identifying and analysing the factors within credit contracts which are of significant importance, such as interest rates and potential fees.

The PB however does not act in this same way and this is due to not receiving the same experiences as the general consumer. This results in prolonged circumstances of very limited

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<sup>212</sup> Boush, *Deception in the Marketplace*, Ibid, at 98.

choice.<sup>213</sup> This prevents them from developing needed self-protection mechanisms against market deception, which is then demonstrated by routinely making poor financial decisions.<sup>214</sup> For the PB, often they will have had very little chance to gain independence to make financial decisions early on in their life. Due to this lack of early independence, from the time of being an early adult, their already deficient financial self-protection skills will have manifested into dependence, placing them in financial survival mode for much of their adult life. In lieu of self-protection mechanisms, they rely on survival mechanisms. This causes the borrower to purely focus on the survival factors within the PL SFC which, as established, are acquiring the required loan amount within the needed time. It will then not be in their nature to examine factors such as interest rates and fees.

Another identified protective coping skill which the general consumer will develop at an early age is managing selective attention and threat recognition. This is achieved by becoming sensitive to significant deceptive threats and recognising the deception threats which are minimal. This also includes foreseeing exposure to significant future threats. This self-protection mechanism is also achieved over time and experienced by developing predictive insights into potentially destructive marketplace situations.<sup>215</sup> The PB does not sufficiently develop this skill. For the average general consumer, alarms bells will likely be sounded at the offer of receiving a \$1000 loan no questions asks, especially when not even their family or best friends will even loan them \$10. For the PB they do not stop to consider that it must be too good to be true. Instead, for the PB there is only a sigh of relief as their immediate problems are temporarily put on hold, completely unaware of any threat or deception.

What is worse for the PB is that instead of their behaviour improving over time, it has been found to be the opposite. Just as good decision-making within the marketplace is a learnt

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<sup>213</sup> As previously submitted in this paper, the average regular payday borrower typically has the characteristics of having limited access to credit, limited financial resources, limited discretionary income and a limited fix income. This results in limited choice when obtaining certain goods and services.

<sup>214</sup> Undeveloped executive function skills has been found to lead to poor self-control, impulsivity, poor judgement in decision-making, failure to organise and plan ahead, difficulty integrating knowledge with future goals, difficulty implementing strategies, perseverance of inappropriate behaviour, difficulty sustaining attention, and difficulty simultaneously processing multiple sources of information. The combined effect of this is an inability to make sensible financial decisions. See Boush: *Deception in the Marketplace*, above, at n 207, at 139.

<sup>215</sup> L G Aspinwall, S E Taylor "A stitch in time: Self-regulation and proactive coping" (1997) *Psychological Bulletin*, 121, at 417-436.

behavioural skill, likewise is poor decision-making. Once the behaviour which leads to poor decision-making has been learnt, it can be very difficult to unlearn. It has been found that correcting decision-making skills can be extremely difficult for some consumers to achieve and may only be corrected through corrective experience over a long period of time.<sup>216</sup> It has been suggested that this skill of learning good decision-making and unlearning bad-decision-making, or disentangling poor decision-making from good decision-making, is achieved through focussed practice rather than by being learnt from being told “the right way” of doing things.<sup>217</sup> Unfortunately for the PB, they typically do not have the resources available to them needed to reverse their mind-set and re-learn sound, logical and responsible financial decision-making. This leaves the PB in their internally vulnerable position and unable to improve their dependent and vulnerable standing in the marketplace.

## **(ii) The Inevitable Problem**

The second factor of the unfair system is the PB’s inevitable problem. For both the general consumer and the PB, a time will inevitably arrive when some financial crisis will occur, requiring an emergency line of credit to solve an immediate and unexpected problem. The problem which the PB faces may not be unfair in itself, as the general consumer may likely be faced with the exact same problem or unexpected expense. This may also cause the general consumer to accrue more debt than they are capable of comfortably repaying. What *is* unfair however for the PB, and is the unfair inevitable problem, is that they will be forced to use their inferior and inadequate self-protection skills to solve a problem that requires more advanced self-protection skills than they possess.

Payday lenders are aware of PB’s internal vulnerability. The payday lending industry is essentially grounded in marketplace deception. Their collective moto is “everyone gets in a jam every now and then, but do not worry, we can get you out of this one”. As previously submitted, the payday lender will not only accept the PB which mainstream credit rejects, but

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<sup>216</sup> Y Schul, R Mayo, E Burnstein and N Yohalom “How people cope with uncertainty due to chance or deception” (2007) *Journal of Experimental Social Psychology* 43(1), at 91-103.

<sup>217</sup> Boush, above n 207, at 98.

they will actively seek them out to offer assistance. When the lenders do this, the PB will not be able to recognise this offer of help as being bait to the trap. Rather than focussing on the terms of the help or questioning the reasons for why the lender would want to help them when no one else would, they instead focus solely on the fact that they have a problem, they need help, and there is at least some help available. With no one else immediately offering assistance to their immediate problem, the PB takes the first offer they have. They then accept the offer of help without giving the required amount of thought to the cost of the offer, which would be expected of a consumer interacting independently in the marketplace. Rather than going through a logical thought process and drawing on past experiences to determine the best option to take, they will instead simply use the PL, especially if they have used them before.<sup>218</sup>

It is obviously undesirable for the PB, or for any consumer, to behave in this way. Price ought to be something that all adult consumers take into account when contracting for all product and services. Just as all adults enjoy a certain level of autonomy, in return society expects a certain level of basic responsibility of all adults. The ideal then for consumers, including PBs, is to modify behaviour if possible. This has been recognised, and in New Zealand and many jurisdictions, much effort and resources have been invested by governments and charitable organisations to develop programs to improve financial literacy so internally vulnerable consumers are able to begin the process of better protecting themselves over time. There have been various and extensive attempts to achieve this.

One way in which self-protection skills have been advanced by the government to improve financial literacy is advertising. If part of the problem is that payday lenders are frequently the first to get to the PB in their time of need, then it follows that giving these consumers an early alternative option will be beneficial. This has been achieved by advertising government or charity subsidised available credit options in low income areas where PLs are often the first response to times of financial hardship. Despite this seemingly being a substantial benefit to excluded borrowers, especially due to it requiring low effort from the borrower to receive the benefit, this has been found to be of minimal success.

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<sup>218</sup> The Productivity Commission, Australian Government, "Review of Australia's Consumer Policy Framework" Inquiry Report No 45, 30 April 2008.

In New Zealand, the Thames Coromandel Woman's Loan Fund organisation for example advertises in low income areas the availability of low cost loans to woman on benefits trying to re-enter the workforce. The loans are in place to provide finance for woman with little to no savings and limited credit options to purchase basic essentials needed to be in the position to accept employment. However, it has been found that this option is not often pursued by the borrowers on their own accord, but usually only when they have been directed to use it after financial difficulty has already occurred, pushing them further away from being in an employable position. The Good Shepherd and the Salvation Army also run and advertise community finance initiative offering interest free and low interest loans to desperate consumers requiring urgent credit, yet they are not bombarded with requests for help as it might be expected.

It has been found that it is not only offers of just financial assistance through advertising that are rejected by PBs, but also non-financial assistance to immediate problems. As has been suggested, household essentials are the leading reason that brings the PB to the lender, however another common reason is the need for reliable transport. This led a group of woman in Timaru to assist in this problem by running a low interest loan scheme to unemployed woman requiring transport. The purpose of this was to provide an alternative option to third tier credit for a specific group of consumers. This particular group of consumers had been recognised as particularly vulnerable to acquiring crippling debt over unaffordable cars, made even more unaffordable when purchased using third tier debt. This had often resulted in debt spirals for this particular group of consumers.

This organisation was first introduced for the purpose of enabling woman to obtain transport so they could get back into the workforce, get off welfare and become self-sufficient. The organisation does more than just provide the finance however. They also find the cheap cars, do all the checks and repairs making sure the cars are sound, and then loan the money at a low rate. This group advertises their service, and would seem to be the ideal option for any low income consumer requiring transport. Yet, despite this, it does not attract anywhere near the same interest as the nearby payday lenders for eligible consumers requiring finance to either get vehicle repairs done or purchase budget cars.

This minimal success in advertising alternative credit has been found to also be the case when the financial problem is specifically anticipated and the advertising for the alternative credit is specifically targeted to that financial problem. An example of specific advertising to solve a potential financial problem failing is the advertising of alternative credit options for outstanding utility bills in Melbourne. It was found that 20% of the time PLs were taken out by residents of a low income area for the purpose of paying outstanding utility bills. In response to this, extensive advertising had been done in this area advising the option of simply going to the utility supplier to refinance the overdue bill directly with them and pay a very small amount of interest over a long period of time. This option would have been ideal for a consumer in that position, however it was found to be seldom taken up and the third tier credit option to solve the financial problem remained the preferred option in that area.

The problem with relying on increased financial literacy is that it is geared towards solving conceptual failure, however this is not the heart of the problem. For consumers like PBs, their failure to adequately protect themselves is not so much due to a conceptual failure, but rather a task performance failure, which requires learning responsibility and executive function skills. These qualities are not learnt from an acquisition of information over a short period of time when they are immediately required, but rather development in early adolescence and continue to be refined and consolidated into early twenties.

From this, it can be suggested that simply providing information does not change behaviour for some consumers who have a history and tendency to behave in a specific way. The reason for this is because they are not able to give enough attention or weight to new information if it deviates too extremely from what they have previously been doing, even if what they have been previously been doing has only lead to their situation deteriorating. It has been found that the reason for this tendency to repeat harmful decisions is that they do not have the skill or confidence to voice aloud at an early stage that something is wrong with the decision. Instead, they are passive to initial internal concerns and “go along with it”, allowing an obviously bad decision to gain momentum until the bad decision begins making sense and seems logical.



The skill to avoid allowing bad ideas to appear good requires time to develop and is also gained through experience through an accumulation of resources and skills. These include social resources, financial resources and skills needed to deal with reoccurring problems regarding life choices.<sup>219</sup> Without previously acquiring the basic background of experience, skills and resources, the disadvantaged consumer is prevented from working through basic decisions and is vulnerable to repeating costly mistakes.<sup>220</sup> This is supportive to the theory of extending increased consumer protection to those at the lower end of the socio-economic echelon rather than increasing the amount of financial information available to them. Evidence of this is the thousands of New Zealand PBs who get trapped in debt spirals every year despite the continued effort from government policies to improve financial literacy of consumers identified as being frequent and regular users of third tier credit. It has been found that for the majority of these consumers who become caught in long term crippling debt, they only ever eventually recover with on-going free help from severely limited and under-funded financial services. This now leads to the third factor of the unfair system, being the inability to recover.

### **(iii) The Inability to Recover**

The third factor of the unfair system is the PB's inability to recover from financial over-commitment, and is the factor which is the most destructive to the PB. The general consumer is not immune to mistakes, so is also not immune to debt spirals. However, as discussed, the general consumer with their superior self-protection skills will be much better placed to avoid them. In addition to this, research also suggests that if the general consumer does get into an unfortunate debt spiral, they will have the ability to recover much more quickly from it and with much less long term financial harm than the PB.

It has been found that the skills required to recover from financial hardship and over-commitment cannot easily be taught to some internally vulnerable consumer, resulting in them remaining within the unfair system despite efforts from themselves and others to modify their behaviour post financial hardship. This is because for these types of consumers, after engaging in a type of behaviour for a long period of time, even if that behaviour has led to obvious and

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<sup>219</sup> L G Aspinwall, S E Taylor "A stitch in time: Self-regulation and proactive coping", above at n215, at 417-436.

<sup>220</sup> Boush, *Deception in the Marketplace*, at n 207, at 130.

severe harm to them and the connection between the harm and the behaviour is apparent, there will still be a lot of difficulty and resistance in changing the behaviour.

When they PB gets themselves into financial hardship from a debt spiral, it is not really by accident, like with a general consumer. Instead, it is more like deliberate and conscious behaviour. To varying degrees, it is likely that the PB has been consciously making poor financial decisions leading to similar harm since they were teenagers or early adults. By the time they get to be in the position of being responsible for children and regular financial outgoings such as bills and debts which cause debt spirals, this consumer will have been engaging in consciously poor financial decision-making for many years. It has been found that the longer a consumer has been engaging in poor decision-making behaviour, the longer it will be before they are able to successfully correct it. This is because although a consumer may have facts and evidence before them that the behaviour they have been engaging in is deteriorating their position, if it is familiar from repeated exposure, the consumer will be guided towards wanting to believe there are still at least some elements to it which are correct, at least for them.<sup>221</sup>

For all consumers, falsely held beliefs and attitudes are difficult to alter once they have been held for a long period of time, and altering entrenched beliefs can require intense coaching experiences that permit practice and mastery of specific focal skills.<sup>222</sup> This suggests the task is far more intensive than simply telling a consumer the “right way of doing things” or simply suggesting they “sharpen up”. Essentially what is required is an attitude adjustment rather than an acquisition of information. This is done through reweighing existing attitudes, which is an acquired skill within itself which is only achieved through practice.<sup>223</sup>

Another problem with the PB attempting to alter behaviour and attitude required to recover from financial hardship is an inability to develop motivation and maintain motivation to

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<sup>221</sup> L Hasher, D Goldstein and T Toppino “Frequency and conference of referral validity” (1977) *Journal of Verbal Learning and Verbal Behaviour* 16, at 107-112.

<sup>222</sup> A Bandura, *Self-efficacy: The exercise of control*. (W. H. Freeman, New York, 1997)

<sup>223</sup> R Ahluwalia “Examination of the psychological processes underlying resistance to persuasion” (2000) *Journal of Consumer Research* 27, at 217 – 232.

achieve the adjustments. A person's motivation to learn how to effectively develop self-protection skills will increase considerably through late adolescence and early adulthood, so it is during this time a person can become seriously disadvantaged if they are not properly motivated to learn basic essential protection skills. During early adulthood especially, motivation to learn protection skills will increase for the average general consumer as the value in it will become apparent to them through their everyday tasks and goals, such as making increasingly significant and numerous buying decisions, establishing and maintaining an independent identity, and managing more complex social relationships.<sup>224</sup> In doing this, small rewards are earned, such as increased savings, acquisition of desired assets and the ability to access low interest-bearing credit from earning good credit ratings. If the consumer has never experienced these rewards then there will be a lack of motivation to attain them.

Another issue that can hold back a consumer with low self-protection skills is overconfidence, which stems from their lack of knowledge. This is in line with the saying "the more you know, the more you know you do not know". It has been found that over-confidence mutes motivation to continue learning and improving skills. Sagarin has found that adolescents who are slower to develop self-protection skills than their peers are exponentially disadvantaged later in their lives due to their perceived invulnerability to marketplace threats. This leads to a lack of motivation in skill upgrade and over time an inability to learn new skills.<sup>225</sup>

The combined effect of this unfair system is that the PB will remain disadvantaged, exploited, and in hardship. The debt spirals they enter are an unfair result of the unfair system. The PB is essentially forced into a credit contract which they do not want and will only cause them harm. The severity of the harm this causes them and the under-recognised victims, being their children, is unacceptable. The combined effect of this places the PB as a unique consumer due to their extreme vulnerability to extreme harm which they did not have a reasonable opportunity to avoid.

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<sup>224</sup> Boush, *Deception in the Marketplace* above, at n 207, at 150.

<sup>225</sup> B J Sagarin, R B Cialdini, W E Rice and S B Serna "Dispelling the illusion of invulnerability: The motivations and mechanisms of resistance to persuasion." (2002) *Journal of Personality and Social Psychology*, 83, at 526-541.

This section has argued and given evidence that the typical PB, defined as a consumer who is on a low fix income, has low assets, is financially excluded, and either carries chronic third tier problem debt or has a history of chronic third tier problem debt, ought to be treated as separate class of consumer from the general consumer when they enter a PL SFC. As a separate class on consumer, it is submitted that they ought to receive different treatment, and in this case increased consumer protection when entering a PL.

It has been identified in Section One of this thesis that there are high risks of objective unfairness to the general consumer when they enter PL SFCs. It has been submitted that these risks are due to an inability to negotiate, bounded rationality, and unequal bargaining power. Due to the narrowness of equitable remedies and the incompatibleness of CCT with modern credit contracts, substantive protection through legislation has been made available in many jurisdictions to protect against potential unfairness to consumers, including New Zealand, the United Kingdom and Australia. The next section of this thesis will examine the current legislative consumer credit protections, analysis their effectiveness for the general consumer, and determine whether they are appropriate and sufficient to protect the PB as a separate class of consumer.

## SECTION THREE

### **5. Current Legislative Consumer Credit Protection in New Zealand**

Legislative consumer credit protection and substantive protection is an alternative to CCT and is in complete opposition to CCT. This protection essentially translates to all concluded consumer credit contracts being susceptible to alteration or unenforceability. A new form of substantive consumer protection has become available in New Zealand in the last decade where contracts may be re-opened based on their substantive fairness. If the contracts are found to be unfair or in violation of the objective standards that the protections set through the inclusion of unfair terms, then the terms of the contract may not be binding, or the contracts themselves may not be binding.

Contractual intervention for substantive unfairness has been more controversial than procedural unfairness and has attracted substantial resistance from the business community. As has been stated, business relies on certainty.<sup>226</sup> The way in which consumers act is not always certain, and as discussed, they often make mistakes. If those mistakes lead them to entering unfair credit contracts, through substantive protection those consumers now have a

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<sup>226</sup> See, New Zealand Post, Submission to Ministry of Consumer Affairs (NZ), Consumer Law Reform: A Discussion Paper, 4 August 2010; New Zealand Retailers Association, Submission to Ministry of Consumer Affairs (NZ), Consumer Law Reform: A Discussion Paper, July 2010; Rae Nield, Les Mills New Zealand Ltd, Submission to Ministry of Consumer Affairs (NZ), Consumer Law Reform: A Discussion Paper, 3 August 2010.

recourse of relief from their objectively unfair deals.<sup>227</sup> For the lender, certainty in contract is lost, the borrower receives an advantage, and there is nothing to be gained for the lender except increased risk in an already risky business.

Despite the controversy of New Zealand's recent overhaul of third tier credit protection and substantive protection, it is not a new or radical concept for legislation to intervene in consumer contracts.<sup>228</sup> Aside from many jurisdictions already enacting legislation to grant substantive protection against unfairness in consumer credit contracts<sup>229</sup> and placing interest rates caps on credit contracts, CCT had already been previously weakened in New Zealand prior to this. This is especially so in the last decades of the 20th century through other consumer protection statutes which regulate consumer contracts. Such statutes include, the Consumer Guarantees Act 1993, the Illegal Contracts Act 1970 and the Contractual remedies Act 1979. This indicates that the New Zealand Parliament have long acknowledged that the days of caveat emptor are gone in respect to contracts between suppliers and consumers.<sup>230</sup>

The specific New Zealand consumer credit protection legislation this section will analysis is the Fair Trading Amendment Bill 2019 ("FTAB"), the Credit Contracts and Consumer Finance Act 2003 ("CCCFA"), the Credit Contracts Legislation Amendment Act 2019 ("CCLAA"), and the unfair terms provisions of the Fair Trading Act 1986 ("FTA"). This paper will begin with the FTAB and examine how it may assist the general consumer and PB in regards to unconscionable conduct by the lender.

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<sup>227</sup> In the report Review of Australian Consumer Policy Frameworks, Volume 2, Inquiry Report No 45 (May 2008), the Productivity Commission identified a number of arguments that provide a rationale for intervening in unfair contract terms contained within standard form consumer contracts. A key argument is that fairness is a highly valued ethical norm held by most people within society.

<sup>228</sup> Sims, above n 43, 740.

<sup>229</sup> *Competition and Consumer Act 2010* (Aust) Sch 2; *Fair Trading Act 1999* (Vic) pt 2B; *Unfair Contract Terms Act 1977* (UK) c 50; *Unfair Terms in Consumer Contracts Regulations 1999* (UK) SI 1999/2083. See also *Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts* [1993] OJ L 95/29; *Consumer Contract Act 2000* (Japan); *Consumer Protection Act 2008* (South Africa).

<sup>230</sup> Sims, above n 43, 751.

## **A. The Fair Trading Amendment Bill 2019**

The FTAB was introduced as an amendment to the FTA in response to the on-going concerns of traders exploiting consumers in the marketplace. Under section 7 of the FTAB it states that a person must not, in trade, engage in conduct that is unconscionable. In regards to credit contracts, this prohibition on unconscionable conduct applies to the circumstances surrounding the formation of the contract, the way the contract is enforced, and the terms of the contract themselves. This will then also include the price, since the price is included as a term under the contract. At this stage there is no indication to suggest that the price under the contract will be exempted from challenges of unconscionability in the way that upfront price is exempted from challenges of unfairness under the FTA's unfair terms provisions, however it seems that unconscionability as a remedy for a consumer caught in a credit contract where the price is objectively unfair may be of little use to a borrower. This is due to the difficulty in establishing a price to be unconscionable. The FTAB does not define what is unconscionable, however the prohibition is intended to address similar problems Australia has dealt with regarding unconscionable conduct.<sup>231</sup>

In Australia, the courts have found conduct to be unconscionable where it is “against conscience by reference to the norms of society”.<sup>232</sup> In Australia these norms have been found to include acting honestly, fairly, and without deception or unfair pressure. It seems that these factors are again, like the common law test for unconscionability, very much to do with process rather than substance, which will prove of little assistance to remedy substantively unfair terms and price. Under section 8 of the FTAB however it does provide a list of factors which a court may have regard to in determining whether conduct is unconscionable. Although some factors listed, such as the terms themselves generally, does suggest that the bill is aimed at substantive unconscionability rather than purely procedural unconscionability, however no factors listed mention price or unfairness associated with the price under the contract. As for terms other than price however, the FTAB may prove to become a valuable form of substantive consumer

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<sup>231</sup> Cabinet Paper “*Unfair Commercial Practices: Policy Decisions*” (19 August 2019) at [21].

<sup>232</sup> *Australian Competition and Consumer Commission v Lux Distributors Pt Ltd* [2013] FCAFC 90 at [23].

protection. One way in which this bill may be of assistance to the typical PB is with wage garnishment.

If it can be found that the lender has the intention of using wage garnishment as a means to pressure the borrower into rolling over their loans to stay more in debt and for longer, then this pressure may be seen as dishonest and deceptive. This is because it implies to the borrower that staying longer in debt is the best, or only option for them, when in fact the borrower will often have multiple options. Deceiving or pressuring the PB into their worst option, being the option of paying much more interest over longer periods of time to the lender seems to be the kind of conduct that the Bill was introduced to prevent. Although there may be some weight to this argument, the lender may have a stronger argument that the borrowers that come to them are risky, cannot be relied upon to always pay their bills on their own accord, and in certain circumstances rolling over the loan is realistically their only option.

Where the Bill may be of help to the PB is limiting the way the WG term can be used, rather than prohibiting it. In this context, a significant help would be prohibiting the term from being used in an unconscionable way, in regards to the amount that can be garnished and the timing of the garnishment. Also, another option which seems to be in line with the purposes of the Bill is to use the Bill to freeze the garnishment for a period of time where there is substantial hardship, similar to the unforeseen hardships provisions in the CCCFA.

The issue of how lenders advertise may also fall under unconscionability. The slogans used by particularly payday lenders, such as “bad credit OK” and “beneficiaries welcome” implies that the borrower is the right person for this line of credit and that they have come to the right place. However, this in fact is wrong, as consumers with bad credit ratings and those on benefits or low incomes are not in the position to be taking on high interest debt. They are the wrong consumers for this product. Payday lenders often cite in response to this criticism that their service is for the consumer who can comfortably repay high cost credit, and simply needs a one off line of credit for an unexpected emergency. The FTAB may be useful in the sense that it may prevent them from targeting the PB in their advertising and force them to change their slogans to “have regular employment, usually financially stable but an unexpected emergency



has occurred? We can lend you some money on this occasion. It is very expensive and is likely not a good option or your best option, but if you are stuck now and have a plan to pay it back, we can help you out.” Although it certainly is not as catchy, it is fairer and more correct.

Although the FTAB will be of little assistance to both the general consumer and the PB in regards to a fair price, the FTAB may be of some assistance to the PB in regards to the WG term and restricting how it can be used. The next piece of legislation this section will examine is the CCCFA and how it may assist the general consumer and the PB against oppressive credit contracts and oppressive conduct from the lender.

## **B. The Credit Contracts and Consumer Finance Act 2003**

The CCCFA is the principal legislation which governs credit provision in New Zealand and all lenders within New Zealand are bound by this Act. This ranges from first tier lenders such as mainstream banks, to third tier lenders such as payday lenders. The CCCFA took effect from 1 April 2005 repealing the Credit Contracts Act 1981 and the Hire Purchase Act 1971 which in the opinions of Parliament were not keeping up with current credit contract concepts or procedures.<sup>233</sup> It was Parliament’s intention that the Commerce Commission would have the responsibility of enforcing and administering the CCCFA,<sup>234</sup> and it would be strictly their role to investigate any breaches to the Act.<sup>235</sup>

The purpose of the CCCFA is found in section 3 of the Act and has the primarily purpose to protect the interests of consumers in connection with credit contracts ... (s 3(1)). Key features to achieve this primary purpose of the Act include: requiring disclosure of adequate information to consumers ... (s 3(3)(b)); to provide rules about interest rates, credit fees, default fees, and payments in relation to consumer credit contracts ... (s 3(3)(c)); to enable consumers to seek

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<sup>233</sup> Duncan Webb *Credit Contracts and Consumer Finance in New Zealand* (1<sup>st</sup> ed, Thompson Brookers, Wellington, 2004) at 2.

<sup>234</sup> Credit Contracts and Consumer Finance Act 2003, s 111.

<sup>235</sup> Above, section 111(2).

reasonable changes to consumer credit contracts on the grounds of unforeseen hardship; to promote and facilitate fair, efficient, and transparent markets for credit ... (s 3(2)(b)); to prevent oppressive credit contracts ... (s 3(2)(d)(i)) and oppressive conduct by creditors ... (s 3(2)(d)(ii)). This indicates the purpose of the Act is to protect against both substantive and procedural oppression, however it seems the focus of the Act may have still been on process rather than substance.

In enacting this legislation, Parliament recognised two key elements for the need for this consumer protection legislation, both grounded in procedure. First was the need to protect a potentially vulnerable sector of the community, being those who are commercially inexperienced, unsophisticated and naïve, from being exploited by unacceptably unfair practices of profit driven businesses. In addition to this, the second key element recognised by Parliament was the power imbalance between lenders and borrowers and the potential for the leverage the lenders possess to be abused.<sup>236</sup> From this it would appear that the intended purpose of the Act is to protect vulnerable borrowers from abusive conduct of lenders.<sup>237</sup> Conduct, as has been established, is usually related to process rather than substance. However where there are elements which are directed specifically towards substance of credit contracts is the prohibition of oppressive credit contracts. It is possible that the way in which the WG term is used may come under the CCCFA's meaning of oppressive and could be considered an oppressive condition within the credit contract.

Section 120 of the CCCFA provides for a remedy where the creditor has behaved oppressively by including oppressive conditions within their credit contracts. This oppression provision has been carried forward into the Act from the Credit Contracts Act 1981. Section 120 of the CCCFA permits, but does not require, the Court to reopen a credit contract if it considers the contract is oppressive. Oppressive is defined in section 118 of the Act as meaning "oppressive, harsh, unjustly burdensome, unconscionable, or in breach of commercial practices." From this broad definition it is difficult to determine precisely where a credit contract will transition from being not oppressive and hence permissible, to oppressive and prohibited. Tipping J's dictum

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<sup>236</sup> E W Thomas "A Critique of the Reasoning of the Supreme Court in *GE Custodians v Bartle*" (2011) New Zealand Law Quarterly 17, at 104.

<sup>237</sup> Thomas, *Ibid*, at 104.

in *Greenbank New Zealand Ltd v Haas*<sup>238</sup> suggest that since all the various words used in the Act's definition which together form the definition of oppressive all contain the underlying idea of a "contravention of reasonable standards of commercial practice,"<sup>239</sup> current commercial standards may be the benchmark. The Supreme Court case of *Ge Custodians v Bartle*<sup>240</sup> suggest that current market standards will be a significant factor in determining oppression within a credit contract, whether it is concerning the inclusion of particular terms or the total price under the contract. .

In *Bartle* the Court made a point of restating the standard to be met in finding oppression within the meaning of the Act. Adopting the standard set in *Greenbank*<sup>241</sup>, the Court stated the loan in that case was not oppressive "in the sense of being in breach of reasonable standards of commercial practice."<sup>242</sup> There has been some criticism over oppression being defined as a breach of commercial standards. Thomas argues that it ought to be presumed that Parliament intended the definition of oppression to carry its ordinary dictionary definition and "should not then be whittled down by a judicial gloss."<sup>243</sup> Thomas continues to argue, with reference to the fact that the definition within the legislation comprises of various words which are clearly disjunctive, that there is no logical reason why a court should focus on one particular word and determine that a breach of reasonable standards of commercial practice ought to attain the "status of the touchstone or template" in determining oppression.<sup>244</sup>

However, it can also be argued that due to section 5(1) of the Interpretation Act 1999<sup>245</sup>, it was Parliament's intention for oppression to be defined by the courts so long as that definition has regards to the purpose of the statute. With the purpose of the Act being to protect those who are potentially vulnerable from unfair or exploitive credit contracts, it would seem the Court

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<sup>238</sup> *Greenbank New Zealand Ltd v Haas* [2000] 3 NZLR 341 (CA)

<sup>239</sup> *Ibid*, at [24].

<sup>240</sup> *Ge Custodians v Bartle* [2010] 1 NZSC 146, [2011] 2 NZLR 31.

<sup>241</sup> *Greenbank*, above, at n 238, at [24].

<sup>242</sup> *Bartle*, above at n 240, at [52].

<sup>243</sup> Thomas, above at n 236, at 107.

<sup>244</sup> Thomas, *Ibid*.

<sup>245</sup> This section provides that "the meaning of an enactment must be ascertained from its text and in light of the purpose."

has not stepped beyond their authority in imposing their own perception of oppression within the contexts of consumer protection.

In *Bartle*, the Court found that the contract in question was ultimately not oppressive because knowledge could not be attributed to GE Custodians that their advancing of the loan under the credit contract was in breach of reasonable standards of commercial practice. Nor were the circumstance such that they should have been led to make any further inquiries.<sup>246</sup> Although increased lender responsibilities which the Credit Contracts and Consumer Finance Amendment Act 2014<sup>247</sup> has introduced would likely result in *Bartle* now being decided differently and oppression found, it would not be for the reason of oppression moving from the benchmark of current commercial standards. Rather, the reason for this is due to the lender's lack of actual knowledge of commercial standards being breached no longer being able to be used as a shield. Due to *Bartle* being a Supreme Court decision, in the absence of legislation amending the Act to provide specific guidance as to the definition of oppression, it would seem current commercial standards will remain the benchmark.

In the contents of the payday lending market, this will likely mean that the standard within the third tier lending market itself will be the benchmark for oppression. This would mean that so long as the entire payday lending industry continues to contain what could otherwise be considered oppressive terms and oppressive price under their credit contracts, they will not be found to be oppressive under the Act, as they are merely the current commercial standards. *Bartle* noted in its judgment that within commercial standards and market conditions, higher interest rates and protective terms reflect the greater risks imposed on the lender. With the majority of PBs being typically risky borrowers, it would seem that oppression as a broad safety net for all users of credit contracts will not be sufficient protection for vulnerable PBs. The PB will instead need something more specifically tailored for them.

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<sup>246</sup> Above at n 240, at [61].

<sup>247</sup> Part 1A of the Credit Contracts and Consumer Finance Amendment Act 2014 now places higher standards of lender responsibilities upon lenders than the Credit Contracts and Consumer Finance Act 2003 did which was the standard when *Bartle* was decided.

In regards to an unfair, or oppressive price, a common response to this problem in many jurisdictions including New Zealand has been interest rate caps on credit contracts. The next piece of legislation this thesis will examine which specifically addresses interest rate caps is the CCLAA.

## **C. The Credit Contracts Legislation Amendment Act 2019**

The CCLAA is a consumer credit protection Act specifically designed to protect vulnerable borrowers from high cost third tier credit. Unlike the CCCFA, this Act does not catch all lenders, but only third tier. The Act puts a cap on the total cost of lending, including interest and fees. It is a very new Act, but its origin began over a decade ago with proposals of interest rate caps on consumer credit contracts.

### **(i) History of Interest Rate Cap Proposals in New Zealand**

The option of protecting vulnerable borrowers by use of interest rate caps was first introduced in New Zealand by Carol Beaumont representing Labour when reforms were being proposed for the CCCFA in 2007. Beaumont recognised that the cause of debt spirals was low incomes, combined with predatory lending which targets these low income borrowers. It was Beaumont's view that interest rate caps on third tier credit contracts would reduce the detriment to third tier borrowers, as had been already implemented in France, Germany, Canada, Mexico, South Africa, USA, UK, Japan and Singapore. Australia also followed suit shortly after in 2010 when reforming their consumer credit protection, and it was the effects of interest rate caps in Australia which was most closely followed in the later years of New Zealand debating the benefits and usefulness of interest rate caps.

New Zealand's first direct proposal for introducing interest rate caps on third tier lenders through amendments to the CCCFA was brought to Parliament by Charles Chauvel representing Labour in 2009. This initial proposal however was voted against in 2009. The issue was then addressed again in 2013 with the Credit Contracts and Financial Services Law Reform Bill

2013. In the First reading of this Bill on 17 September 2013, Julie Genter representing the Green party supported Beaumont and the proposal of interest rate caps. Genter noted that debt spirals were rampant amongst fringe credit borrowers at that time, of which 44% of borrowers were using the credit to purchase essential items,<sup>248</sup> and cited an instance of where an initial \$800 loan spiralled into a \$70,000 debt. Genter argued that the cause of many of these debt spirals was due to the large interest rates on the loans. David Clark representing Labour also argued for interest rate caps in referencing that other jurisdictions had acknowledged that interest rate caps were a necessity for reform to be effective.

The Second Reading of the Bill was on 10 April 2014 where National supported the Credit reform proposed by the Bill, but brought forward reasons for opposing interest rate caps. These reasons included the cap becoming a target rather than a cap, and that the cap would exclude some borrowers from being able to access any credit at all. Kris Faafoi representing Labour criticised National's reasons for opposing an interest rate cap, insisting that caps do work and the unintended detrimental consequences cited by National would be minimal and not sufficient justification to reject caps.<sup>249</sup> This was argued with reference to Australia, the United Kingdom and Canada, where there had been a reduced usage of budgeting services and evidence that caps had only resulted in excluding 10% of fringe borrowers who realistically could not afford the loan in the first place. Had these PBs not been excluded, their loans would have resulted in being rolled over to begin an inevitable debt spiral.

At the third reading of the Bill on 27 May 2014 Labour continued to advocate for interest rate caps with Louisa Wall referring to an article by Catriona MacLennan titled "cap an easy way to protect vulnerable from loan sharks"<sup>250</sup> which claimed an increasing number of desperate

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<sup>248</sup> Evidence of this was supported by Clare Curran representing Labour and referencing findings from catholic Social Services, Anglican Family Care, Methodist Family Mission, Presbyterian Support and the Salvation Army.

<sup>249</sup> Catrina MacLennan in her article "Interest Rate Cap Needed in New Zealand", her speech to Thames Coromandel Woman's Loan Fund on 28<sup>th</sup> May 2015, she aggressively advocated for caps to be put on payday loans. MacLennan believes that it does not matter if the cap becomes the target. If the cap is a reasonable amount of interest, then it will not matter if the cap is the target, as it will still be less than what the industry is currently charging. This will also provide certainty and make borrowers more aware of their rights.

<sup>250</sup> Catriona MacLennan, *cap an easy way to protect vulnerable from loan sharks* (2014) [https://www.nzherald.co.nz/personal-finance/news/article.cfm?c\\_id=12&objectid=11250619](https://www.nzherald.co.nz/personal-finance/news/article.cfm?c_id=12&objectid=11250619) at 7 May 2014. Above, at n 249, MacLennan noted that the vulnerable are deceived into a spiral of debt by such slogans as "no credit checks", "bankrupt ok", and "lend to beneficiaries". Then, once you're in, you are at the mercy of the lender, as they can charge you whatever they want, and there are no rules against them doing that.

and vulnerable borrowers were in need of immediate protection.<sup>251</sup> Also cited by Wall was the extensive research conducted by Louise Signal, Associate Professor from Otago University, on third tier lending. It was noted that Signal's research suggested that interest rate caps were a necessity for the reformed legislation to be strong enough to give adequate protection to the targeted community and this would be the only way to see an improvement in the lives of those who constantly depend on the credit of third tier lenders.<sup>252</sup>

National however continued to oppose the interest rate caps in insisting that the caps were a blunt instrument and would not address the total cost of borrowing. This is perhaps correct, as lenders would be able to still provide just as expense credit to vulnerable borrowers through the use of exuberant establishment fees, default fees and other fees. Ultimately the proposal of interest rate caps was voted against in the Bill and the opportunity to include caps in the consumer credit reform of the CCCFA in 2014 was missed. In determining how much of a missed opportunity this may have been for the general consumer and also the PB, other jurisdictions where interest rate caps have been adopted are useful to analysis. Two jurisdictions which this paper will examine is Australia and the United Kingdom.

## **(ii) Interest Rate Caps in Australia**

In Australia, interest rate caps are also relatively new, having been late compared to other jurisdictions to adopt interest rate caps. Although the harm third tier credit causes to low income borrowers in Australia has been severe, wide spread, and raised much concern to policy-makers, there has been some caution in taking up this approach.

On 21 September 2011, the Federal Minister for Finance Services and Superannuation, Bob Shorton, introduced into Parliament the Consumer Credit and Corporations Amendment (Enhancements) Bill 2011. This bill amended the National Consumer Credit Protection Act 2009, including an amendment to short term, high interest loans. This put in place caps on

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<sup>251</sup> Ministry of Consumer Affairs Regulatory Impact Statement: Responsible Lending Requirements for Consumer Credit Providers (14 October 2011)

<sup>252</sup> Louise Signal, *'Loan Sharks' need tougher regulation and control* (2012) <https://www.otago.ac.nz/news/news/otago036145.html> at 20 August 2012.

interest rate, fees and other charges on payday loans. It also put restrictions on refinancing of existing loans. This bill harmonised existing state and territorial consumer credit laws, as some states, NSW, QLD, and VIC already had a form of caps on payday lending.<sup>253</sup>

This Bill was in response to studies conducted into payday lending in Australia by first the Consumer Law Centre in July 2002 by Dean Wilson,<sup>254</sup> then by Zac Gillam conducting research into the growth of short term lending in Australia between 2002 and 2010<sup>255</sup> and reporting to the Consumer Action Law Centre in September 2010, and then Marcus Banks reporting on the role of small short term loans for Australians.<sup>256</sup> All three reports indicated that there was a need to give more protection to vulnerable borrowers due to evidence that many Australians who were already struggling were falling into the debt spiral trap.

At the introduction of the Bill the issue of payday lending got a lot of media attention.<sup>257</sup> Vince Chadwick stated that in Melbourne, Victoria, a region which had already introduced a cap on payday lending, what had been done there had worked well in reducing harm to borrowers. Less than 10% of borrowers thought that their short term loan had improved their situation, where more than 60% thought the loan had led to a spiral, which is in contrast to what Cash Converters suggest, that the ability of borrowers to access these loans is an essential service being provided.<sup>258</sup> It was unanimous that the harm was concerning and immediate action was needed to protect consumers. Collectively, the suggested form of action to reduce this harm

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<sup>253</sup> Ali, McRae, Ramsay, "The Politics of Payday Lending Regulations in Australia" 2013 Monash University Law Review 411, at 411-412.

<sup>254</sup> D Wilson, *Payday Lending in Victoria- A Research Report* (Consumer law Centre Victoria Ltd, 2002), above at n120.

<sup>255</sup> Zac Gillam and the Consumer Action Law Centre, "Payday Loans; Helping Hand or Quicksand? Examining the Growth of High-Cost Short-Term Lending in Australia, 2010-2010" (Research Report, September 2010)

<sup>256</sup> Marcus Banks "Caught Short- Exploring the Role of Short Term Loans in the lives of Australians" (Final Report, August 2012)

<sup>257</sup> See, eg, Vince Chadwick, 'Pay-Day Loans No Solution for Most, Survey Finds', *The Age* (Melbourne), 13 August 2012, 3; Mike Seccombe, 'Canberra is Protecting Loan Sharks. Yes, You Read Right', *The Global Mail* (online), 2 August 2012; Ruth Williams, 'Anger over Changes to Payday Loans', *The Sydney Morning Herald* (Sydney), 25 April 2012, 4; John Rolfe, 'Having a Lend of the Poor — Shorten's Cash Conversion', *The Daily Telegraph* (Sydney), 25 February 2012, 16; Jane Searle, 'Responsible Lending Laws "Failed"', *The Australian Financial Review* (Sydney), 6 December 2011, at 41.

<sup>258</sup> Vince Chadwick, 'Pay-Day Loans No Solution for Most, Survey Finds', *The Age* (Melbourne), 13 August 2012



from the leading studies conducted was for the government to introduce an interest rate cap on the cost of borrowing.<sup>259</sup>

The government however was not completely convinced on this approach, and was still cautious over the issue of third tier lenders still being able to charge overall extremely high costs of borrowing through fees, which may not protect the borrower from debt spirals. Although interest is one way in which lenders generate high profits, it is not the only way. It was correctly noted that establishment fees, default fees, default interest and rolling over of credit, could still make the loans particularly burdensome.<sup>260</sup> The other main issue of concern was that interest rate caps may cause lenders to leave the market or being more selective in their lending, which may cause some borrowers to be completely excluded from all forms of credit.

Despite the concerns, the Australia government opted to respond to the problem of harmful credit contracts by including in their 2013 credit reforms of the National Consumer Protection Act 2009 with an interest rate cap on borrowing at 48% per annum, 20% for establishment fees, and then 4% per month (originally the cap was set at 10% for establishment fee and 2% interest per month, but this was later increased to 20% and 4%). It was acknowledged that this elective carried some risk and concern, yet it would be trialled and would be subject to review after the effects of it were observed in the marketplace.

In response to the effects of the reform, Andrew J Serpell noted that although the 2013 reforms improved protection to borrowers, more changes may be warranted.<sup>261</sup> This was because

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<sup>259</sup> Treasury, Australian Government, *The Regulation of Short Term, Small Amount Finance: Regulation Impact Statement* (June 2011) 51, 59–60 ('Regulation Impact Statement').

The Impact Statement anticipated that the caps and restrictions on refinancing would both reduce the cost of borrowing and mitigate the risk of hardship to borrowers, without causing excessive harm to the payday loan industry as a whole. It was found that the minimum cost to advance a loan was 20%, so the payday lenders would still be able to stay viable with the cap in place.

<sup>260</sup> An added disadvantage is that default or dishonour fees may also incur, from both the bank and the lender, penalising the borrower twice over, which is often the case according to the *Caught Short* Report, making the small loan in the end very expensive and difficult to recover from.

<sup>261</sup> Andrew J Serpell, "Protecting the Desperate: The Regulation of payday Lending" 43 *Federal Law Review* 147 (2015), at 148.

With reference to Marcus Banks, "Caught Short: Exploring the Role of Small Short Term Loans in the lives of Australian", Final Report August 2012 Serpell notes that 70% of payday borrowers in Australia are on below

although in Australia caps were a necessity, it may not be enough. Also, getting the cap amount correct is just as important as having them. Finding the correct cap amount was noted to be a difficult task, as the amount may likely change as the market changes. Therefore, as opposed to setting the cap at a permanent and fixed amount, a better approach would be to treat it as an ongoing task and subject to regular review.<sup>262</sup> Within the regular review process it has been suggested that taking into regard the responses from financial advisors, the borrowers themselves and the public at large would be important and helpful within the process.<sup>263</sup>

On 15 October 2015 the Community Action Law Centre also commented on the review of the law reform. Regarding the issue of interest rate caps, it was identified that although caps had achieved the objective in reducing the cost to borrowers, it had not reduced the risk of borrowers entering debt spirals, suggesting that fees, default fees, and the regularity of using the loans were also significant factors with debt spirals. In Australia it has been acknowledged that no matter how close the cap gets to what is the ideal cap amount, this will not alleviate all detriment to the borrower. The main problem is low incomes and consumers not having enough on a weekly basis to cover their day to day needs. For this reason these borrowers are not going to be able to get out of debt no matter who they borrow from. They are always going to have multiple loans going and will constantly be in debt. Reducing the cost of borrowing will reduce the harm but not prevent it. There will always be a cost of using money that you don't have.<sup>264</sup>

It has been identified that the leading factor which continues to worsen the borrower's situation despite the introduction of caps in Australia, is the rolling over of loans and frequent use of

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average incomes, 25% are below the poverty line, and 50% are on benefits. On top of this it has been shown that borrowers tend to be young, many do not have English as their first language, many have health, drug and gambling problems.

<sup>262</sup> Serpell, above, at n 261, at 176.

<sup>263</sup> The introduction of the reform caps on payday loans in Australia was a well-covered issue in the media at the time of the credit contracts review. This indicated that consumers and the public at large see this issue as being an important one. The Sunday Morning herald in 2016 has ran a number of articles putting short term lending practices into the limelight. See: March 24, 2016, in "Online payday lenders under scrutiny following Nimble investigations" by Georgia Wilkins; April 20, 2016 in "SACC lenders say caps could put some out of business", by Shaun Drummond; March 4, 2016, in "Cash Converters turns to debit cards for payday loans" by Georgia Wilkins; September 9, 2016, in "Cash Converters to refund almost \$11 million to payday loan customers" by Patrick Hatch; February 29, 2016, in "Cash Converters cashes in on online payday loans" by Georgia Wilkins and Clancy Yeates.

<sup>264</sup> Ali, McRae and Ramsay, discuss the different jurisdictions and how the caps have worked in in "Payday Lending regulations and borrower vulnerability In the UK and Australia", *Journal of Business Law* 2015 3, 223-255.

loans.<sup>265</sup> In fact, it has been found that the industry is still able to thrive, as their business model is set on the reliance that borrowers will not be able to meet the obligations of their loans, allowing lenders to charge default fees and roll over fees on top of the 48% cap<sup>266</sup> put in place.<sup>267</sup> With the automatic debit system also in place, any money that the borrower has will usually go to the lender first, meaning that when the borrower does default, they will be in a desperate position that can be taken advantage of by the lender. Due to this, it has been suggested that now more than ever with the introduction of caps, lenders will have an incentive to make loans to borrowers who will not be able to afford them.<sup>268</sup> Should the lenders then not be able to do this, there is the obvious concern some PBs will be completely excluded from all credit.

In regards to the issue of some borrowers being completely excluded from all credit options, on 14 March 2011 Matthew Drummond warned in the Australian Financial Review that the cap would prevent many borrowers from being able to find credit. Referring to the Corones Report,<sup>269</sup> Drummond suggested that if caps were to be effective then many smaller lenders would be likely to leave the industry, resulting in a reduction in the availability of PLs, and for these excluded borrowers to resort to looking into illegal lenders. In Australia however this has

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<sup>265</sup> The Consumer Credit Legal Centre (NSW), Submission to the Financial System Inquiry, Parliament of Australia (April 2014) 22, suggested that even with the caps in place, payday lenders could still only be used as a temporary fix and frequent use would always be at the expense of making the initial problem worse down the line. It was found that even with the new restrictions in place on lending and the reduced cost of borrowing through caps, an analysis of payday loan users found 80% of payday loans taken out never helped improve the borrower's financial position.

See also Sally Andersen, "Mapping the Terrain: the last decade of Payday Lending in Australia" (2011) 39 Australian Business Law Review 5. Andersen suggests that the capping of the fees by the government has not slowed down the growth, but had capped the profit. The payday lenders have managed to get around the bump of the caps by making up for it with rolling over of loans and default fees and interest, also the number of times borrowers use the service within a year.

<sup>266</sup> <https://www.finder.com.au/payday-loan-interest-rates>, shows that the 48% cap on lending for payday lenders seems to be the target. Most payday lenders have resorted to this cap as the minimum cost of a short term loan.

<sup>267</sup> Matthew Drummond, "Payday Lenders Warn of Market Exit" The Australian Financial Review, 14 March 2011. Drummond referred to a study lead by Stephen Corones from the Queensland University of Technology, and funded by the National Financial Services Federation that suggested that interest rate caps could easily be circumvented by lenders by increasing their others charges, such as establishment fees, defaults fees, and costs for rolling over loans. This would lead to an incentive for lenders to target borrowers who are in tight financial situations and likely to default. For that reason the study suggests that interest rate caps on their own would not be sufficient to give borrowers the proposed protection.

<sup>268</sup> Financial Conduct Authority, "Consultation Paper: Detailed Proposals for the FCA Regime for Consumer Credit" October 2013.

<sup>269</sup> D McGill, S Corones and N Howell, "regulating the Cost of Small Loans: Overdue or Overkill?" (2012) 30(3) *Company and securities Law Journal* 149.

not been the case, as since the reform there has been a steady increase in the number of lenders in the industry and the number of loans being taken out. This may be precisely because the reforms do not in fact work. It is still difficult to assess the full effects of the Australian reforms, as they are still relatively new and operate within a relatively small market. However, the United Kingdom is another jurisdiction where interest rate caps are new, but there they operate within a much bigger market.

### (iii) Interest Rate Caps in the United Kingdom

In the United Kingdom, borrower vulnerability was also at the heart of the debate as to whether to include cost of borrowing caps in the United Kingdom,<sup>270</sup> and this was a key factor in prompting the Chancellor of the Exchequer to finally announce on 25 November 2013 that the correct response would be an interest rate cap on third tier lending.<sup>271</sup> Third tier lenders targeting and exploiting vulnerable borrowers had long been a concern, however in the United Kingdom the response to the problem of payday lending had traditionally been relatively non-interventionist. The Office of Fair Trading (the “OFT”) had previously relied on the payday lending industry to police itself via codes of practice and industry associations, with the OFT only making incremental adjustments to the conduct of market participants.<sup>272</sup> The United Kingdom in fact used to have restrictions on costs of consumer credit contracts, but abolished these restrictions when it enacted the Consumer Credit Act 1974 (UK),<sup>273</sup> preferring an approach that better educated the consumer, in hope that a better informed market would make less harmful decisions, rather than prohibition from entering certain contracts.<sup>274</sup>

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<sup>270</sup> Ali, McRae and Ramsay wrote an article “Payday lending and borrower vulnerability in the UK and Australia” *Journal of Business Law* 2015 3, at 225

<sup>271</sup> A. Monaghan, ‘Payday Loans face Cap by City Regulator’, *The Guardian*, 26 November 2013; Financial Conduct Authority, ‘Policy Statement PS 14/16: Detailed Rules for the Price Cap on High Cost Short-Term Credit including Feedback on CP 14/10 and Final Rules’ (November 2014), at 5.

<sup>272</sup> Office of Fair Trading, n 14 above, 54; I. Ramsay, ‘Consumer Law, Regulatory Capitalism and the “New Learning” in Regulation’ (2006) 28 *Syd L Rev* 9, at 18-20.

<sup>273</sup> Caps were replaced in the United Kingdom with a statutory power for courts to intervene in consumer credit agreements where a court determines that the relationship between the lender and borrower arising out of the agreement is ‘unfair’ to the borrower: Consumer Credit Act 1974 (UK), s 140A(1). In making this determination, courts can take into account the interest rate and the financial vulnerability of the borrower.

<sup>274</sup> Department for Business, Innovation & Skills, ‘Consumer Credit and Personal Insolvency Review: Formal Response on Consumer Credit’ (November 2011), at 3.

On the 2<sup>nd</sup> January 2015 when interest rate caps finally came into law in the United Kingdom, it had been made clear that the old approach of relying on increased consumer financial literacy and industry self-governing was over. Although there was some resistance due to whether an interest rate cap was the correct protection response, it was extensively agreed that something much more was needed than was currently in place. The main reason for finally conceding to interest rate caps being introduced was the evidence of the growing market for payday lending, targeting of vulnerable borrowers<sup>275</sup> and the widespread non-compliance of lender obligations.<sup>276</sup>

The cap in the United Kingdom was structured as follows: (i) all interest and fees charged during a payday loan or when refinancing cannot exceed 0.8% of the outstanding principal of the loan per day; (ii) default charges cannot exceed £15; and (iii) the total of all interest, fees and charges cannot exceed 100% of the total amount borrowed.<sup>277</sup> The difference with this cap from that in Australia is that as well as a cap being placed on interest, there is also a cap on the total amount. This addressed one of the concerns raised in Australia and New Zealand over interest rate caps not representing the total cost of borrowing. However, the concerns over restrictions on interest rate caps, or restrictions on total cost caps would not completely solve

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<sup>275</sup> On the 12<sup>th</sup> March 2014 an article in the Guardian by Tom Warren identified that there was now one short-term loan store for every seven banks, making the total number of short-term stores being 1,427 in the UK, and 49 in Northern Ireland, and they were disproportionately located in the impoverished communities. Paul Blomfield, MP for Sheffield and a lending anti-payday loan campaigner said that clustering these shops in impoverished communities exacerbated the negative impact that payday lenders were having on the country. He suggested that the council needed to use their powers to restrict the number of shops that could be allowed to operate in these areas. In Lewisham, one of the poorest areas in south-east London, had 7.6 stores for every 100,000 people, and is currently the capital of short term credit in London. Glasgow is the city which has the 5<sup>th</sup> largest number of short-term credit stores in the UK, with 6.7 for every 100,000 residents. In West Dunbartonshire, an area with a particularly high saturation of payday stores, found that the area had 26% of children growing up in poverty, and 24% deriving at least part of their income from welfare, compared to a UK average of 15%. The regulatory study done in the United Kingdom since the global financial crisis on payday lenders was in June 2010 in "Office of Fair Trading Report ("OFT") 1232: Review of High Cost Credit Final Report". Here the findings were that the system seemed to be working reasonably well, but concerns remained over borrower vulnerability.

<sup>276</sup> The Good Practice Customer Charter noted that there was widespread non-compliance with the industry's own code of practice after reviewing 44 lenders, showing that the self-regulation was not working and was not good enough to protect the consumer, as per "Making Consumer Credit Markets Fairer" a report done by the Department of Business, Innovation and Skills in October 2013. Since the regulatory intervention of the market the OFT investigated 50 lenders, which resulted in 19 exiting the lending market. The reasons identified for the market acting recklessly towards borrowers was that the market competed mainly by the speed at which a loan could be given, rather than the cost of the loan to the borrower. Due to this there was a big incentive for lenders to not do an adequate affordability assessment.

<sup>277</sup> Financial Conduct Authority, 'Policy Statement PS 14/16: Detailed Rules for the Price Cap on High Cost Short-Term Credit including Feedback on CP 14/10 and Final Rules' (November 2014), at 5.

the problem of debt spirals due to loans being rolled over, and also that some borrowers may become completely excluded from all credit.<sup>278</sup>

The OFT in a survey in 2010 expressed the view that caps would not be an appropriate solution as it would mean that many lenders would exit the market and many borrowers would lose all access to credit.<sup>279</sup> The Bristol University study also identified that the caps would create the new problem of some lenders exiting the market or excluding some types of borrowers.<sup>280</sup> In February 2014 the Financial Conduct Authority (“FCA”) responded to this concern by reporting that an estimated 11% of borrowers would be excluded with the introduction of caps, as per the FCA’s report “Proposals for a price cap on high-cost short-term credit” in July 2014.<sup>281</sup> However, this could be seen as a good thing, as these borrowers are the most at risk, so it is likely that these borrowers could not afford the high cost loan in the first place. To not grant the loan then is likely to be in their best interests anyway. However, this does not solve the problem of where these 11% of borrowers are going to access needed credit. In order to deal with the problem correctly it is likely that the government is needed to find another option for these most excluded borrowers to get affordable credit.

As for the second concern, there remained doubts that caps would be a sufficient solution to the payday lending problem, as it would not address the problem of the loans being rolled over and limiting the real cost of borrowing. The Bristol University study noted this problem, advising that an interest rate cap would not address the most destructive and harmful aspect of payday loans to borrowers, being the number of times the loan is rolled over, and the taking out of multiple payday loans.<sup>282</sup>

For the caps to have any real value then they would need to be coupled with restrictions on rolling over of credit and limits on the number of loans a borrower can have at any one time.

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<sup>278</sup> Financial Conduct Authority, ‘Occasional Paper No. 1: Applying Behavioural Economics at the Financial Conduct Authority’ (April 2013), at 34.

<sup>279</sup> Office of Fair Trading, ‘Report 1232: Annexe B – Price Controls’ (June 2010), at 27-30.

<sup>280</sup> University of Bristol, above at n 132, at 119.

<sup>281</sup> Financial Conduct Authority, ‘Policy Statement PS 14/3: Detailed Rules for the FCA Regime for Consumer Credit including Feedback on FCA QCP 13/18 and “Made Rules”’ (February 2014); Financial Conduct Authority, “Proposals for a price cap on high-cost short-term credit” (July 2014), at 11, 29, 61-63.

<sup>282</sup> University of Bristol, above at n 234, at 119.

The OFT report in 2010 suggested measures to prevent the damage to borrowers from continuing to roll over their loans by requiring the lender to do a full and intensive affordability assessment before a loan is given. If the borrower has already got an overdue loan then it will be assumed that a further loan would not be appropriate.<sup>283</sup> Second, it has been suggested that a limit should be put on the number of times a loan could be rolled over, limiting this number to only 2, as opposed to the number of times currently loans were rolled over with a report of one loan being rolled over 12 times.<sup>284</sup>

This led to the FCA responding in part to this concern by placing restrictions on loan roll-overs. These restrictions came into effect from 1 July 2014, limiting the number of times a PL can be rolled over to two roll-overs per loan.<sup>285</sup> Although these provisions do not address the concerns of the PBs taking out multiple loans from multiple lenders, it does seem to be a welcome step forward in vulnerability protection. Despite prevailing concerns, New Zealand has recently taken a very similar approach to the United Kingdom with consumer credit protection in caps on total cost of third tier loans.

#### **(iv) Cost of Credit Caps in New Zealand**

The issue of interest rate caps on third tier credit contracts never ceased being a live topic within New Zealand Parliament, and when the power shifted to Labour, the issue was addressed again with the Credit Contracts Legislation Amendment Bill 2019. This Bill was introduced by Kris Faafoi representing Labour, and took a new approach to consumer credit protection than had been done in the past in New Zealand. This Bill, rather than only restricting interest rate caps, also restricted the total cost of third tier credit to borrowers. In addition to introducing an interest rate cap of 0.8% per day, Subpart 6A of the Bill, which introduced provisions relating to debtors under high cost consumer credit contracts, also placed a cap on the total cost of the loan. This included all fees as well as the interest payable upon the loan. Under section 45A of the Bill, the cost of borrowing will not exceed the loan advance. Essentially this means that all

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<sup>283</sup> Office of Fair Trading, 'Report 1232: Review of High Cost Credit Final Report' (June 2010), at 4, 6, 45-46.

<sup>284</sup> Office of Fair Trading, 'Report 1481: Payday Lending Compliance Review Final Report' (March 2013), at 9, 11, 14-15.

<sup>285</sup> Financial Conduct Authority, 'Consultation Paper CP 13/10: Detailed Proposals for the FCA Regime for Consumer Credit' (October 2013), at 63.

the interest, fees and any other costs cannot be more than the original amount advance, capping the total cost of the loan at 100%. The Bill received Royal assent of 19 December 2019 and the regulations relating to new requirements on high-cost lenders, including the total cost of credit cap and rate cap will come into effect on 1 June 2020.

To an extent this addressed one of the issues which National identified when opposing interest rate caps 5 years earlier. Under the CCLAA, lenders will no longer be able to recoup lost interest with increased fees. It does not however address the concern of borrowers losing access to their only available form of credit, which will now become more of a concern than ever. From the lender's perspective, there will now be a hugely increased incentive for them to become more selective in who they lend to. It is unclear at this stage how the government is planning to address the likely problem of increased lender selectivity, as there has yet been no announcement of alternative credit options for borrowers excluded from third tier credit.

Rob Stock wrote in Stuff on 13/4/2014 in "Informal Loans rate High" that New Zealanders have one of the highest reliance on informal loans, and 11% on all loans granted in 2013 were informal loans from third tier lenders. Back in 2013 there was a strong concern over vast amounts of payday lenders leaving the market and becoming exponentially selective, as the need for PLs were very much present despite their high cost of borrowing and them being detrimental. It was noted that in order to faze them out, it needed to be a gradual process rather than an immediate action. If they were quickly forced out through restrictive legislation without something else to fill the gap, there would certainly be severe temporary hardship to those currently reliant on them.

The CCLAA will likely be of significant benefit to the general consumer, and also the PB in many regards. However, in other regards this could also be a step backwards for the PB, where their debt spiral and eventual hardship of not having enough food, the lights going out, moving to inadequate accommodation and stress being taken out on their children, gets bought forward to the present. The problem which essentially needs to be solved is not so much how to exclude PBs from bad credit, which the CCLAA achieves well, but instead how to help PB's access fair credit.



Another problem with the CCLAA is that with the third tier credit industry being vast, there will be many different situations and circumstances associated with different loans. The CCLAA essentially treats them all the same. With a cap of 100% on the total that can be recouped on a loan, it is far more blunt of an instrument than an interest rate cap. Where an interest rate cap may not necessarily equate to a fair price on the credit, a total cap on price is exponential worse. It treats all borrowers the same, whether the borrower pays on time or irresponsibly and deliberately defaults on payment. It essentially penalises borrowers who responsibly pay their loans on time. It may well be that a struggling PB pays the same cost for a loan as another irresponsible PB in the same situation. This all but encourages delinquency. Under this new cap there is little incentive for a borrower to willingly repay a loan on time. If the borrower continues to default and makes the lender chase them, the worst that can happen to them under the Act is to pay the maximum recoupable amount under the cap. In many circumstances it could well be that completely adhering to the obligation of the loan and completely disregarding it will be at the same cost to the PB.

It seems that the one way in which the lenders will still be able to protect themselves is through wage garnishment and automatic debit authorisations. For lenders who do chose to stay in the market and continue to lend to high risk borrowers, the likely outcome will be that lenders will abuse further the already harmful and often unfair wage garnishment option.<sup>286</sup> In the United Kingdom, which as discussed, now has very similar third tier credit protections as New Zealand, there is evidence of significant abuse of this occurring.<sup>287</sup> Since the credit protections reform in the United Kingdom, third tier lenders there have used the continuous payment authorities, being their term for wage garnishment, as one of the main incentives for them to continue to make loans to borrowers who cannot necessarily afford those loans. Most likely New Zealand lenders will follow suit, and wage garnishment will in fact begin being used as a first response, rather than as the described last resort. This will especially be the case if

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<sup>286</sup> Payday lenders routinely use wage garnishment as a debt recovery tool. Following a borrower's default, a lender will often repeatedly make requests for payment under its payment authority to the bank at which the borrower's account is held to obtain access to whatever moneys may come into the borrower's account as soon as those moneys are available. See Business, Innovations & Skills Committee, 'Debt Management: Fourteenth Report of the Session 2010-2012' (HC 7 March 2012), at 20.

<sup>287</sup> Using the continuous payment authorities in the United Kingdom, payday lenders have been known to frequently take larger amounts than previously agreed from a borrower's bank account, leaving the borrower in a desperate position to find ways of meeting weekly expenses. See University of Bristol, n 134 above, at 47.

postponing its use will only result in increased cost to the lender. In order to understand how this can harm the borrower just as much as a high cost of borrowing, it is necessary to examine wage garnishment.

### (v) **Wage Garnishment**

Wage garnishment is a term used when an employer withholds a portion of an employee's wages for the purpose of either reimbursing themselves<sup>288</sup>, or reimbursing a third party for a debt owed. In many jurisdictions, before wages can be garnished, the creditor must first sue the debtor for the unpaid amount and obtain a court judgment order. In New Zealand, due to changes made first under the District Court Amendment Act 2011,<sup>289</sup> then later under the District Court Act 2016, the civil debt enforcement system has been streamlined to make the debt recovery process faster, easier and cheaper for creditors. Now, through court imposed attachment orders, the use of general wage garnishment clauses and terms such as the WG term which all PL SFC include, there is no need for a creditor to go to court to sue for their debts. Instead, creditors can use their SFC to tap into the salaries or benefits of borrowers who miss repayments.<sup>290</sup>

Budget agencies in New Zealand have expressed concern about high-interest PLs requiring borrowers to sign and agree to wage deduction authorities and wage garnishment clauses as part of their SFCs,<sup>291</sup> and would like to see only court-ordered wage deductions allowed.<sup>292</sup> Australia have a similar system of wage garnishment of debtors, however a maximum is set at

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<sup>288</sup> Such deductions may include the cost of work-specific uniforms, tools, meals, lodging, and or wage overpayments. Any such deductions however require specific written consent from the employee before any deductions can be made. See section 5 of the *Wages Protection Act 1983*.

<sup>289</sup> Sections 84G and 84H of the *District Courts Amendment Act 2011*. Repealed on 1 January 2018, pursuant to section 240 of the *District Court Act 2016*. Section 180 of the *District Court Act 2016* outlines the current garnishee proceedings.

<sup>290</sup> The process to recover debt before the amendment used to require at least two court appearances, a requirement for the order to be served on the other party in person, and a \$250 fee to change, change or cancel the order. Now it can only take one court hearing, orders can be served electronically, and the fee for changing an order has been waived.

<sup>291</sup> See Rob Stock, 'Complaints grow about high-cost, short-term lenders' *Stuff* (online), 2 October 2017, <http://www.stuff.co.nz/business/money/972/6544/complaints-grow-about-highcost-shortterm-lenders>; n 70.

<sup>292</sup> Ibid. Joseph Liava'a, the chair of the Viola Pacific Island Budgeting Service, said there was a legal process through the courts which lenders can use to get attachment orders to get their money repaid directly from defaulted borrowers' wages.

20 per cent of the gross amount of the debtor's wages. In contrast, in New Zealand there is no legal maximum, and this has led to payday lenders typically garnishing between 20-40 per cent.

Darryl Evans from the Mangere Budgeting Service has commented that due to this "[t]he reality is our families are struggling, and there is very little left over." Evans has suggested "[t]here needs to be a maximum amount set," and according to him an appropriate amount "would be 10 per cent."<sup>293</sup> According to the Federation of Family Budgeting Services ("FFBS"), this process of recovering debt through attachment orders is being abused by lenders. FFBS have stated that they had 50,000 new clients seeking help in 2015, the year after the changes, which was five times more than the previous year.<sup>294</sup> This presents evidence that for at least some third tier borrowers in New Zealand, the WG term presents a danger and ought to be an issue of immediate concern.

It is submitted that although capping total price of a loan, which the CCLAA does, will help the PB, it does not lead to a fair price for credit being achieved or remove enough unfairness within the payday lending industry. In order to achieve fairness, fairness must be the focus, rather than establishing a cap. This fairness is to do with both a fair price and fair terms. One piece of New Zealand consumer protection legislation which focuses specifically on this issue of fairness is the unfair terms provisions of the FTA.

## **D. The Fair Trading Act 1986**

As discussed, under CCT objective unfairness of specific terms freely agreed to, like the WG term and the price, are irrelevant in the absence of questionable conduct leading to the formation of the contract. In New Zealand, until the inclusion of the provisions in the FTA prohibiting unfair terms, at no time has equity or common law allowed a contract to be set aside

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<sup>293</sup> Ibid.

<sup>294</sup> See Susan Edmunds, 'Commerce commission announces plan to put lenders under scrutiny' 19 February 2016, *Stuff* (online) at <https://www.stuff.co.nz/business/77074045/null>.

simply because the specific terms themselves are deemed substantively unfair. The focus has always been on the relationship between the parties and the conduct of the stronger party.<sup>295</sup>

Now, under section 46 of the Fair Trading Amendment Act 2013 which introduced the unfair terms provisions, legislation has provided statutory standards of substantive fairness against which the terms can be assessed, rather than focusing exclusively on the procedural circumstances of contractual formation. Through these unfair terms provisions, it is now possible to re-open concluded contracts and examine the fairness of the terms themselves. In order to determine whether this substantive protection from unfair terms offered in New Zealand will be of assistance to the PB in avoiding objective unfairness, this part will investigate what the substantive protection currently includes and what its effect will be on the concerning short-falls of the CCLAA.

To doing this, the definition of an unfair term under the legislation will be analysed, and the likely extent and parameters of this definition examined. This will be determined first by analysing the purposes and objectives of this substantive protection and how those purposes and objectives are thought to be achieved. In order to achieve that it is helpful to first analysis the history of the Bill which introduced substantive protection against unfair terms into New Zealand.

### **(i) History of the Fair Trading Amendment Bill**

On 17 March 2015 amendments to the FTA preventing unfair terms within standard form consumer contracts came into force in New Zealand.<sup>296</sup> Prior to the amendments being passed, the process of including the unfair terms clause into the FTA arguably began in 2006 where

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<sup>295</sup> Under general contract law based on the concept of substantive unfairness, there is no general jurisdiction for courts to intervene in an otherwise validly formed contract if the conditions for voluntary decisions by contracting parties have been met. See *O'Connor v Hart* [1985] 1 NZLR 159, 171; *Nichols v Jessup* [1986] 1 NZLR 226, at 235 per Somers J.

<sup>296</sup> New Zealand's unfair contract terms law is contained in the *Fair Trading Act 1986* ss 26A, and 46H- 46 M. The *Fair trading Act 1986* was amended by the *Fair Trading Amendment Act 2013*. The unfair contract terms law applies only to contracts that were entered on or after 17 March 2015, or for contracts entered into before this date if the contact was varied or renewed on or after 17 march 2015.

the New Zealand Ministry of Consumer Affairs voiced its support for introducing prohibitions on unfair terms in SFCs. This occurred during the early stages of a comprehensive review of all New Zealand Consumer laws.<sup>297</sup> This was in response to the Commerce Commission acknowledging that it, ‘received many complaints over the years about potentially unfair terms in SFCs that gave companies and business significant rights at the expense of their customers’ and ‘that these terms might cause significant consumer harm’.<sup>298</sup> Despite these expressed concerns and the Ministry of Consumer Affairs accepting that unfair contract terms were being used in New Zealand,<sup>299</sup> the recommended amendments to consumer protection were not put in place at that stage.

Later, in June 2010, the New Zealand Ministry of Consumer Affairs released a Discussion Paper, Consumer Law Reform. This Discussion Paper repeated that there is a strong case for prohibiting unfair contract terms in New Zealand.<sup>300</sup> The New Zealand consumer law review eventually culminated in the New Zealand Consumer Law Reform Bill 2011 (the “Bill”),<sup>301</sup> yet provisions concerning unfair contract terms was omitted from the Bill.<sup>302</sup>

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<sup>297</sup> See Ministry of Consumer Affairs, Review of the Reform of the Redress and Enforcement Provisions of Consumer Protection Law- International Comparison Discussion (2006) at pp 24-28 where the Ministry proposes that the Fair Trading Act 1986 should be amended to specifically prohibit unfair terms in consumer contracts.

<sup>298</sup> Prior to International Comparison Discussion in 2006 the Ministry of Consumer Affairs and the Commerce Commission received complaints from consumers where the terms in contracts may not be misleading or deceptive but they do appear to be unfair. One problem with the consumer protection law recognised prior to the unfair contract law was that when consumers recognise that the terms are unfair they sometimes feel they have little option but to sign as there is little or no difference in the contracts used by all providers in that sector. Ibid, at 25. The Commerce Commission has acknowledged however that they continue to receive many complaints despite the change in the law. See Commerce Commission, *Telecommunications Contracts Review: Unfair Contract Terms*, February 2016 <http://www.comcom.govt.nz/the-commission/consumer-reports/uct-reviews/> at [8].

<sup>299</sup> Ministry of Consumer Affairs (NZ), ‘Briefing for Commerce Committee on Consumer Law reform Bill: Including Unfair Contract terms Provisions in the *Fair Trading Act*’ (26 June 2012), [24]. <http://www.parliament.nz/resource/0000216543>

<sup>300</sup> See New Zealand’s Ministry of Consumer Affairs, Consumer Law Reform Additional Paper- September 2010: Unfair Contract Terms at <http://www.consumeraffairs.govt.nz/pdf-library/legislation-policy-pdfs/CLR-Additional-paper---Unfair-contract-terms.pdf>.

<sup>301</sup> Consumer law reform Bill (No.287-1) 2011 (NZ).

<sup>302</sup> On the reasons for omitting the unfair contract terms provisions from the Consumer Law Reform Bill see the response made by the Hon John Boscawen, Ministry of Consumer Affairs (NZ), *Q & A for Consumer Law Reform Decision Announcement* (May 2011) [24] <<http://www.consumeraffairs.govt.nz/pdf-library/legislation-policy-pdfs/Consumer-Law-Reform-Questions-and-Answers.pdf>>. The reasons stated were heavy on the concerns that businesses relied on the certainty of the contracts they enter. Also, there was some criticism that The Discussion Paper did not make a strong case for regulating unfair contract terms as too much emphasis was placed on the alignment with Australian consumer law without sufficient justification.

This issue of unfair contract terms was then addressed again in the first reading of the Bill where the Minister of Consumer Affairs invited the Select Committee to specifically consider whether an unfair terms provision should be introduced to the Bill.<sup>303</sup> In October 2012 the Commerce Committee reported back on the Bill,<sup>304</sup> recommending the addition of section 26A in Part 1 of the FTA which would prohibit the use of unfair contract terms in SFC.<sup>305</sup> Any breach of this new section would give rise to the remedies described in Part 5 of the FTA. In addition to the risk of consumer harm, another reason for the Committee's recommendation was to harmonize New Zealand consumer laws with the Australian Consumer Law ("ACL").

In the first reading of the Bill the Minister of Consumer Affairs noted that the Bill would initiate one of the biggest overhauls of consumer protection law in New Zealand in recent years.<sup>306</sup> Due to the significance of this overhaul, it was acknowledged that for the sake of business efficiency, New Zealand ought to be in sync with its closest neighbour and biggest trading partner. Since ACL had already introduced unfair terms provisions, New Zealand would remain out of sync with Australia if they were not included. With this as a likely concern, the Committee's unfair terms recommendations to the Bill were taken almost in their entirety from Schedule 2 of the Competition and Consumer Act 2010. However, in moving for the second reading of the Bill, the Committee's recommendations differed slightly from the provisions already in place in the ACL.

One significant difference was the effect of the inclusion of section 26A. This section would define a term as an unfair contract term only if it is declared to be such by the High Court or a

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<sup>303</sup> See speech by Minister of Consumer Affairs, Chris Tremain, available at <http://www.beehive.govt.nz/speech/consumer-law-Bill.htm>.

<sup>304</sup> Available at [http://www.parliament.nz/en-NZ/PB/Legislation/Bills/6/f/6/00DBHOH\\_BILL10613\\_1-Consumer-Law-Reform-Bill.htm](http://www.parliament.nz/en-NZ/PB/Legislation/Bills/6/f/6/00DBHOH_BILL10613_1-Consumer-Law-Reform-Bill.htm).

<sup>305</sup> Sections 46H to 46M were recommended to be included in the FTA to give the power to a court to declare a term in a standard form consumer contract to be unfair where a Court finds a term in a SFC met the Acts definition of an unfair term. Once a court had declared a term unfair, the term could not be relied upon by the party seeking to benefit from it.

<sup>306</sup> The unfair contract terms law has been described as '[o]ne of the most substantial changes to consumer laws for 20 years'. See Troy Pilkington, 'New Regime Targets terms in Contract's Fine Print', *Stuff* (online) 21 January 2015, <<http://www.stuff.co.nz/business/opinion-analysis/65245387/New-regime-targets-terms-in-contracts-fine-print>>; The equivalent legislation in the United Kingdom, the Contract Terms Act 1977 (UK) c 50, which for business to consumer transactions has since been replaced by the Consumer Rights Act 2015 (UK), has been described as 'possibly the single most significant piece of legislation in the field of contract law', E Macdonald, 'Scope and Fairness in Consumer Contracts Regulations: Director General of Fair Trading v First National Bank' (2002) 65 *Modern Law Review* 763, at 763.

District Court, and only on the application of the Commerce Commission. With the concerns of the business sector in mind,<sup>307</sup> it was the intention of the Committee that through this process only the Commerce Commission would have control of the enforcement of prohibiting unfair contract terms from SFCs. This was in contrast to the ACL which allowed applications to be made by consumers.

It was identified from this early stage that the recommendations from the Committee regarding substantive protection against the use of unfair terms had the objectives of not only preventing the use of unfair terms in consumer SFCs, but also ‘modernize... New Zealand consumer law, better reflecting the digital and commercial world we live in’.<sup>308</sup> In effect, these recommendations had workability and practicality in mind, affording the changes being made to have a high probability of achieving its objectives. With the Minister of Consumer Affairs believing that the recommendations to the Bill would likely achieve its objectives, the recommendations were endorsed by the Minister of Consumer Affairs and the Bill was then split with the relevant provisions being included in the Fair Trading Amendment Act 2013, which passed with cross-party support.<sup>309</sup>

If these unfair terms provisions do in fact achieve their stated objective in substance by preventing the use of unfair contract terms in consumer SFCs, then in the case of the typical PB, this protection ought to provide protection from the objectively unfair terms which often lead these borrowers into chronic debt spiral. It has been submitted in this paper that 2 such objectively unfair terms within PL SFCs which lead PBs into debt spirals are the WG term and the total price of the contract.

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<sup>307</sup> The Minister acknowledged that the Committee in coming to their recommendation had given due consideration to the arguments made by business groups that the unfair contract terms would cause unnecessary cost to businesses in having to review their SFCs and cause uncertainty in the law by the evidentiary presumptions in favour of consumers. See New Zealand *Parliamentary Debates*, House of Representatives, 11 December 2012. Volume 686, at 7410. The opposition by the business community was acknowledged to have some merit and the concerns regarding uncertainty were especially valid. See Consumer Law Reform Bill (No.287-1) 2011 (NZ), at 20.

<sup>308</sup> The Commerce Commission’s description of the changes made by the *Fair Trading Amendment Act 2013* <<http://www.comcom.govt.nz/fair-trading/changes-to-the-fair-trading-act/>>.

<sup>309</sup> New Zealand, *Parliamentary Debates*, above at n 307, at 7410. The Supplementary Order Paper (218) divided the *Consumer Law Reform Bill* into 6 Bills, thus the part relating to unfair contract terms became the *Fair Trading Amendment Act 2013* (NZ). Supplementary Order Paper (273) provided that the unfair contract term provisions would come into effect 15 months after the Bill receives Royal Assent.

## **(ii) Current Protection under the FTA Unfair Terms Provisions**

In New Zealand substantive protection against unfair terms is defined in section 46 of the FTA. Section 46I (1) of the FTA states that before the protection against unfair terms within a contract can be made available, a jurisdictional threshold of ensuring that the particular contract being assessed for unfairness is a SFC must be passed.

### **a. Definition of a Standard Form Contract**

Section 46J of the FTA defines a SFC as any contract which has not been subject to effective negotiation. What exactly effective negotiation means is not completely clear, however some guidance is given from this section. Section 46J (2) states that in determining whether a contract is a SFC, the court must give mandatory consideration to the following:

- (a) whether one of the parties has all or most of the bargaining power relating to the transaction:
- (b) whether the contract was prepared by one or more parties before any discussion relating to the transaction occurred with the other party or parties:
- (c) whether 1 or more of the parties was, in effect, required either to accept or reject the terms of the contract (other than terms referred to in section 46K) in the form in which they were presented:
- (d) the extent to which the parties had an effective opportunity to negotiate the terms (other than terms referred to in section 46K) of the contract:
- (e) the extent to which the terms of the contract take into account the specific characteristics of any party to the contract.

Where a contract is alleged to be a SFC, section 46I (3) places the onus on the supplier of the contract to prove it is not a SFC. Generally, where a contract is pre-prepared by a supplier, the contract will usually be regarded as a SFC, although it has been argued that provided the contract has been subject to some negotiation, regardless of the quantity or its effectiveness,



the contract may cease to be a SFC.<sup>310</sup> Alexandra Sims however argues that “...it would be rare for a contract which is prepared by a trader and used by that trader for all its consumers acquiring the same goods or services not to be found a SFC, even if one or two of the terms were altered at the consumer’s insistence.”<sup>311</sup>

## **b. Definition of an Unfair Term**

Once it can be established that the contract being examined is a SFC, the test for substantive unfairness of the contractual terms may be applied by the Courts.

The section which sets out the test to determine whether a term is unfair is section 46L (1) of the FTA. This section states that a term is unfair if the court is satisfied that the term-

- (a) would cause a significant imbalance in the parties’ rights and obligations arising under the contract; and
- (b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- (c) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

These three factors must *all* be satisfied, however in addition to this, section 46L (2) also states that in determining whether a term is unfair a court may take into account any matters it thinks are relevant. It is unclear what factors a court may find relevant, and it may also depend largely on the particular contract and the circumstances, however section 46L (2) also states that a court *must* take into account:

- (a) the extent to which the term is transparent;
- (b) the contract as a whole.

It has been established that wage garnishment has the potential to be extremely harmful and even unfair to consumers like the typical PB, so in determining whether this particular

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<sup>310</sup> See A Gray, 'Unfair Contracts and the Consumer Law Bill' (2009) 9 *Queensland University of Technology Law and Justice Journal* 155, at 167-168.

<sup>311</sup> Sims, above n 43, at 760.

protection is likely to be sufficient protection for the PB as a class of consumer, it is helpful to examine the WG term within the application of these unfair terms provisions.

### **(iii) Wage garnishment as an Unfair Term**

#### **a. Significant Imbalance**

As previously stated, in order for a term to be declared unfair under section 46 of the FTA, the term must cause a significant imbalance in the parties' rights and obligations arising under the contract.<sup>312</sup> In determining what the consideration of significant imbalance requires in order to satisfy an unfair term, the Commerce Commission has identified in their draft guidelines regarding unfair terms that there is both a causal connection requirement, as well as a magnitude assessment. This is likely to mean that the term must create the imbalance and that imbalance must be sufficiently significant.<sup>313</sup>

The recent New Zealand High Court decision in *Commerce Commission v Home Direct Limited*<sup>314</sup> will be of much assistance in interpreting this requirement. This decision was the first to be brought before the High Court in New Zealand regarding the new unfair terms provisions and precisely concerned the significant imbalance requirement in declaring an unfair term.

The case of *Home Direct* concerned a “voucher entitlement scheme” where a customer had repaid what they owed to Home Direct Ltd for previous purchases and interest. Home Direct Ltd continued to debit regular amounts from the customer's bank account, with each of those payments converted into a separate “voucher entitlement”. Customers could use their voucher

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<sup>312</sup> Section 46L(1)(a) of the FTA.

<sup>313</sup> New Zealand Commerce Commission Draft Unfair Contract terms Guideline (July 2014) (NZCCDUC) page 8 at [39].

<sup>314</sup> *Commerce Commission v Home Direct Limited* [2019] NZHC 2943.

entitlements to make future purchasers from Home Direct Ltd. The Scheme contained two terms, which in combination the Commission submits were unfair.

- a) Customers could not have their voucher entitlements refunded or exchanged for cash (the No Refunds Term).
- b) The voucher entitlements expired after 12 months (the 12-month Expiry Term).

The combined effect of these terms was that once sums were debited from the customer's bank account and not used to purchase goods from Home Direct Ltd, within 12 months those sums were forfeited to Home Direct Ltd.<sup>315</sup>

Pursuant to the Home Direct Ltd Contract, customers who purchased goods on credit under a Lifestyle Account were required to sign a direct debit authority. The authority allowed Home Direct Ltd to debit the customers' bank account weekly or fortnightly. Customers could opt into the Scheme by initialling a box on the purchase agreement. If they did so, Home Direct Ltd would continue to debit the weekly or fortnightly sum from the customer's bank account after previous purchases and charges had been paid crediting "voucher entitlements" with individually assigned numbers. However, no physical vouchers were issued. The cumulative value of the customer's voucher entitlements represented the total amount the customer could apply to subsequent purchases. Under the Terms and Conditions Home Direct Ltd was entitled to continue to debit a customer's account until the voucher entitlements reached a predetermined maximum.<sup>316</sup> The total value of a customer's credit was represented by vouchers held in the customers Lifestyle Account. Customers did not earn interest on this balance and nor were the funds held on trust or secured. The terms and conditions allowed Home Direct Ltd to use customers' voucher monies as part of its general funds.<sup>317</sup>

In reaching a decision on the case, and due to the absence of any New Zealand authority on the matter, Muir J referred to the Australian case *Australian Competition and Consumer Commission v Chrisco Hampers Australia Ltd*<sup>318</sup> as a guide to the interpretation and application of the unfair terms provisions. This action was taken due to the consideration of significant

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<sup>315</sup> Ibid, *Home Direct Ltd*, at [5]-[6].

<sup>316</sup> Ibid, *Home Direct Ltd*, at [12].

<sup>317</sup> Ibid, *Home Direct Ltd*, at [13].

<sup>318</sup> *Australian Competition and Consumer Commission v Chrisco Hampers Australia Ltd (NO1)* [2015] FCA 1204.

imbalance being adopted almost identically from the equivalent Australian legislation.<sup>319</sup> In *Chrisco*, the unfair term was known as the HeadStart term, which provided for consumer payments to Chrisco to continue even after the customer had paid in full for existing orders. A credit balance accruing in a customer's favour could be used to pay for future orders, but the customer did not receive interest on any amounts held.

*Chrisco* focused almost exclusively on whether the HeadStart term would cause a “significant imbalance in the parties’ rights and obligations arising under the contract”. The Court concluded that it did and accordingly found the term was an unfair contract term. Emerging from the decision it was found that the Court must scrutinise purported “benefits” closely. This would involve closely analysing whether terms which claim to purport benefit to consumers actually do. The Court found that the HeadStart term gave Chrisco the right to withdraw money from a customer's account without any substantial corresponding right or to the consumer. The Court rejected the claimed benefit of a customer being able to use their balance to purchase further products, as they already have the right to do that without the term.<sup>320</sup>

The second point taken from this case was that a “significant imbalance” will exist where a party's obligations and rights are not broadly equivalent. The Court held that there will be an imbalance in the parties' rights where one party is under a significant detriment which is not balanced by a corresponding right.<sup>321</sup> In assessing whether there was a significant imbalance Edelman J consulted the approach taken by Lord Bingham in *Director General of Fair Trading v First National Bank Plc* when interpreting the United Kingdom's equivalent provisions.

Lord Bingham found that “if a term is so weighted in favour of the supplier as to tilt the parties' rights and obligations under the contract significantly in his favour”,<sup>322</sup> then it will qualify as a significant imbalance. This has been interpreted to include granting to the supplier a beneficial option or discretion or power, or the imposing on the consumer a disadvantageous burden or

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<sup>319</sup> Sections 24 (1), (2) and (4) Competition Consumer Act 2010.

<sup>320</sup> *Chrisco*, above, at n 318, at [57].

<sup>321</sup> *Chrisco*, above, at n 318, at [65].

<sup>322</sup> Per Lord Bingham in *Director General of Fair Trading v First National Bank* [2001] 3 WLR 1297, at [17].

risk or duty.<sup>323</sup> Paterson commenting on this argues that in determining whether a term causes an imbalance in the parties' rights and obligations under the contract, the issue should be whether there are burdens placed on the consumer that are not balanced by concessions elsewhere in the transaction.<sup>324</sup>

In adopting this interpretation, Muir J found that 'The No Refunds Term' conferred two significant benefits on Home Direct Ltd. Firstly, because customers could not call for a refund of monies paid into the scheme, the vouchers had to be spent on Home Direct Ltd's products or alternatively forfeited. This gave Home Direct Ltd guaranteed future income. Secondly, Home Direct Ltd obtained the interest free use of the money until a purchase was made.<sup>325</sup> From these benefits gained to Home Direct Ltd and with no benefits conveyed to the consumer, it was found that the term did create a significant imbalance and this led to the term ultimately being declared unfair.

The use of the WG term does not fit well into the circumstances of *Home Direct* or *Chrisco*, yet it can be concluded that essentially the issue requires asking what the borrower gained and what has the lender gained. With the use of the WG term it would seem that the borrower has been placed with all the risk should their circumstances change and not be in the position to meet their commitments, where the lender has been shielded from almost all risk. From this reasoning it would seem that the WG term does form an imbalance as far as where the risks lie within the SFC.

It has been suggested that price may be a relevant consideration in assessing whether there is an imbalance in the parties' rights and obligations under the contract.<sup>326</sup> In an ideal market, the

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<sup>323</sup> K Tokeley, 'New Zealand Moves to Prohibit Unfair Terms: A Critical Analysis of the Current Proposal' (2013) 37 *University of Western Australia Law Review* 107.

<sup>324</sup> Paterson, above, at n 3, 944; One of the limitations with the 'significant imbalance' element identified in the UK is that a balanced contractual offering does not ensure a substantively fair contract. See Law Commission, *Unfair Terms in Contracts: A Joint Consultation Paper* (Law Com No 166, 2002) para 4.90. This is especially true if the consumer is not aware of a term, or is not in a position to calculate a potential risk compared with the benefit of a discounted price. See Santucci, above, at n 37, at 177.

<sup>325</sup> *Home Direct Ltd*, above, at n 314, at [39].

<sup>326</sup> Hugh Collins describes the courts' approach to contractual imbalance under the Unfair Term in Consumer Contracts Regulations 1999, as follows: 'The question which the court must address is whether or not the exclusions, qualifications, and limitations on the trader's obligations are balanced in the contract by either

allocation of a particular risk to consumers should be balanced by a reduction in the price paid by consumers to the trader of the goods or services in question. If it can be shown that the effect of an otherwise onerous term has been offset by a tangible reduction of the contract price, the term will not be imbalanced and hence not unfair.<sup>327</sup> It seems unlikely that any PBs are receiving a price reduction due to the reduction of risk to the lender with the use of the WG term. This is due largely to the interest rates when using third tier lenders compared to first and second tier lenders which do not use a WG term. Also, there appears to be no choice for the borrower to opt for a higher rate of interest in exchange for the removal of the WG term.

In determining whether the imbalance that the WG term causes is significant, the New Zealand Commerce Commission commenting on the suggested meaning of “significant” has unhelpfully identified that much will depend on the facts of the individual case.<sup>328</sup> However, Australian commentary in relation to s 24(1) (a) of the ACL identified that “significant” means an imbalance of bargaining power that is “meaningful” or “of consequence” and “more than trivial”, such that it is deserving of the intervention of the court to avoid the realized or likely consumer detriment.<sup>329</sup> Further to this, Morris P in *Director of Consumer Affairs v AAPT Ltd* observed in relation to the Victorian provisions that “[t]he word 'significant' simply means 'important' or 'of consequence'. It does not mean 'substantial'.”<sup>330</sup> From this it would seem that the “significant” portion of the test is not a burdensome hurdle, and in the case of a term allowing a lender access to a PB’s wages or benefit before them, this will likely satisfy the element.

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similar limitations favouring the consumer or a commensurate reduction in the price’. See *Director General of Fair Trading Ltd v First National Bank* [2001] UKHL 52 (“*First National Bank*”), [2002] 1 AC 481 [37] per Lord Steyn, citing H Collins, ‘Good faith in European Contract Law’ (1994) 14 *Oxford Journal of Legal Studies* 229, at 249.

<sup>327</sup> Paterson, above n 3, at 944; *Director General of Fair Trading v First National Bank plc* [2000] QB 672, at 687, per Gibson LJ; *Jetstar Airways Pty Ltd v Free* [2008] VSC 539 (Unreported, per Cavanough J, 3 December 2009) (“*Jetstar*”).

<sup>328</sup> New Zealand Commerce Commission Draft Unfair Terms guidelines (February 2018) (“NZCCDUT”) page 11 at [52].

<sup>329</sup> S G Corones (ed) *The Australian Consumer Law* (2<sup>nd</sup> ed, Thompson Reuters, Sydney, 2012), at 236, [6.95].

<sup>330</sup> [2006] VCAT 1493 (2 August 2006) [33].

Finally, it has been submitted that in determining whether a term in a SFC causes a significant imbalance, considering the extent to which the term detracts from the rights held by the consumer under the common law or other legislation could provide a helpful indication.<sup>331</sup>

### **b. The Wages Protection Act 1983**

The New Zealand legislation which regulates the conditions for wage garnishment is the Wages Protection Act 1983 (“WPA”). Under the WPA, no deductions from wages in New Zealand can be made except in accordance with the WPA. The default position under the WPA is that subject to sections 5(1) and 6(2), an employer shall, when any wages become payable to a worker, pay the entire amount of those wages to that worker without deduction. However, under section 5 of the WPA, employers can make a deduction from pay if: the deduction is for a lawful purpose; is reasonable and; the employee has agreed to or asked for the deduction in writing.

From first glance it seems that payday lenders are within their rights under the WPA to require employers to garnish a borrower’s wages who fall into default on their loans. The deduction is for a lawful purpose, reasonable in terms of the lender simply pursuing a debt owed to them and the deduction has technically been ‘agreed in writing.’ Under employment agreements it is possible for employers to use general deduction clauses within their employment contracts to legally garnish wages. If the concept of ‘agreed in writing’ can be satisfied through an employee signing an employment agreement which included a general deductions clause, then it seems ‘agreed in writing’ would also be satisfied by a borrower signing a SFC which included a WG term. However, on closer inspection there are some crucial differences.

First, under a general deduction clause in an employment agreement an employer must consult with the employee before they make a specific deduction. From this requirement of consultation before garnishment, it is evident that key requirements are that the employee must first be aware that they have actually consented to any deductions being made. Second, the employee must be aware of the amount which will be deducted. In many cases this is not the

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<sup>331</sup> C Willett, *Fairness in Consumer Contracts: The case of Unfair Terms* (Routledge, London, 2007), at 47.

case, as from Section One of this paper it has been established that borrowers often will agree to SFCs without actually being aware of all the terms within the contract. Also, with garnishment or the threat of garnishment being used to coerce borrowers into rolling over their loans, it is unlikely that the borrowers were expecting the threat.

Through the process of attachment orders, which accompany the PL SFCs, the process of consultation is omitted when garnishing the wages of a borrower in default. This lends to the borrower receiving no warning of the deduction and presenting a danger to the borrower of neither being aware that they had consented to a WG clause, or being aware of the amount which will be garnished. Where this danger eventuates it seems very contestable that signing a SFC which includes a WG term amongst many other terms would qualify as written consent in the sense that was intended in the WPA. If it can be argued that the term was not examined at the time of entering the SFC and there was no consultation before the deduction, then it would follow no true consent to the deduction was made and hence, the requirement of ‘agreed in writing’ within section 5 of the WPA is not satisfied. For the payday lender to use a process which circumvents this requirement may detract from rights the borrower has under the WPA.

This then leads to the requirement of reasonableness within section 5 of the WPA. Section 5A of the WPA reiterates this to an extent stating that no “unreasonable” deductions may be made from an employee’s wages. The issue of reasonableness is inherently difficult to define, so the important question then turns to what constitutes an unreasonable deduction. Case law is clear that a fair process must be followed for a deduction to be reasonable.<sup>332</sup> The problem with the WG term is that it obstructs fair process of the WPA by treating the term as a general deduction clause without specific consent that would be needed if the general clause was between the employer and the employee. The term eliminates any need for the employer to consult with the employee, or advise the employee of their rights or options in relation to it. Case law has suggested that this use of garnishing wages through processes like the WG term where the parties executing the deduction are likely aware that there is no real consent from the employee is not reasonable and not the purpose of the WPA.<sup>333</sup>

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<sup>332</sup> *Amaltal Fishing Company Ltd v Morunga* [2002] 1ERNZ 692, at 34-35.

<sup>333</sup> In *Jonas v Menefy Trucking* [2013] NZEmpC 200, Judge Ford noted at [62]: The provisions of the Wages Protection Act 1983 are mandatory. Under those provisions, an employer must pay the entire amount of wages



Case law also suggests that actual specific consent from the employee ought to be given before any reasonable deductions can be made.<sup>334</sup> This seems to reinforce the requirement of consultation before deduction, even if the borrower was aware of the WG term at the time of entering the PL SFC, or in other words gave consent in advance. Pursuant to this, section 5A may be of further use to the PB as section 5A restricts “unreasonable deductions” from wages regardless of whether these are consented to by workers.<sup>335</sup> This has the effect of restricting what terms and clauses can be used for the purposes of garnishing an employee’s wages on the grounds of consent. If it is found that the consent, whether agreed to by use of a WG term or otherwise, was in relation to an unreasonable deduction, that consent will no longer be sufficient under the WPA.

The second main difference between a general deductions clause in an employment agreement and a WG term in a SFC is that under a general deductions clause the employee can vary or withdraw their written consent to a deduction by giving notice in writing to their employer at any time. Once consent is withdrawn the employer must then vary or stop the deductions within two weeks of receiving the notice or as soon as practicable.<sup>336</sup> Many PL SFCs do include these

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payable to a worker without deduction unless the worker otherwise consents or, in certain circumstances, where there has been an overpayment. In cases such as the present, however, where a general deductions clause in an employment agreement is relied upon rather than an individualised written consent then, consistently with its good faith obligations under the Act, an employer must, at a minimum, consult with the worker before making any deduction. Without such a safeguard, the protection intended to be afforded by the Wages Protection Act 1983 would be illusory. It may also be that no deduction can be made on the basis of a general clause without that worker’s express consent.

<sup>334</sup> As Chief Judge Goddard noted in *Amaltal Fishing Company Ltd v Morunga* [2002] 1ERNZ 692: [33] ...the appellant's practice of deducting such sums of money as it sees fit from the employees' wages to reimburse itself after it has decided to make a payment to a third party based on its perception that there is some moral or indirect legal obligation on it to make the payment. ...

[35] The Wages Protection Act 1983 prohibits any deductions from wages that have not been requested or authorised by the employee in writing, whether the deductions seem justifiable or not. This is because employees have earned their wages which may not then be the subject of any deduction merely because the employer still has their money in its possession and so is in a position of some power. ...Their entitlements are not subject to arbitrary diminution at the instance of their employer. Wages have to be paid in money and not partly in money and partly by discharging debts which seem valid to the employer but the existence or amount of which the employee may wish to dispute or at least to control the timing of their payment having regard to other commitments and needs.

<sup>335</sup> Section 5A of the *Wages Protection Act 1983*. Section 5A: inserted, on 1 April 2016, by section 7 of the *Wages Protection Amendment Act 2016* (2016 No 12)

<sup>336</sup> Section 5 of the *Wages Protection Act 1983*. Section 5(1): replaced, on 1 April 2016, by section 6(1) of the *Wages Protection Amendment Act 2016* (2016 No 12). Section 5(1A): inserted, on 1 April 2016, by section 6(2) of the *Wages Protection Amendment Act 2016* (2016 No 12).

rights under the WPA, however this will be of little practical assistance to the PB if they do not understand the process of withdrawing consent or understand that it is even an option. The inclusion of section 5A is an acknowledgement of this. In addition to the inherent confusion for the borrower over their rights under the WPA, some PL SFCs even require borrowers to agree to “not dispute any deductions”, or that the agreement is “irrevocable.”<sup>337</sup> This gives the impression that the SFC has contracted out from the rights the borrower has under the WPA.<sup>338</sup>

Save My Bacon chief executive Kent Gillman has stated that a WG term is only used as a last resort, when a borrower fails to engage with the lender. Gillman defended the use of the term irrevocable within Save My Bacon’s WG term in stating “A Wage Deduction Authority is irrevocable as between Save My Bacon and the borrower. The authority is not irrevocable in favour of the employer, which is prohibited under the Wages Protection Act.”<sup>339</sup> This however seems illogical, as it is the employer who garnishes the wages, not Save My Bacon. It seems that the payday lender may be attempting to use the implied absolute authority from the WG term to contract out of the WPA. With the typical PB likely having little knowledge of their rights under the WPA, it is likely that this possible breach of the WPA will go unnoticed by the majority of PBs. What is more, the term may also be deliberately misleading, implying to the borrower that by signing the contract they are giving up their common law rights to challenge the legitimacy of the WG term.

At the very least, it would seem that the WG term is not a well understood term for borrowers as far as their rights under the WPA are concerned. The term has the effect of providing another way for lenders to reduce their risk, but at the unexpected expense and potential hardship to the borrower. It seems this term both detracts from consumer rights under the WPA, and also creates a significant imbalance between the lender and the borrower.

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<sup>337</sup> The Payday Advance SFC says borrowers must “agree without dispute” for a wage deduction authority to be served on their employer. Save My Bacon, which said it had made nearly 150,000 loans since it launched in 2010, has borrowers agree to an “irrevocable” assignment of wages.

<sup>338</sup> The Commerce Commission has warned that: “A wage deduction authority should not be described as ‘irrevocable’. Describing it as such is prohibited by section 5 of the Wages Protection Act 1983.... We consider it risks breaching the Fair Trading Act as it may mislead consumers as to their rights.” See Stock, above at n 291..

<sup>339</sup> Stock, above, at n 291.

It appears that the inclusion of the WG term within the SFC will satisfy the test of causing a significant imbalance, as most of the risk and liability of a poor credit borrower is transferred from the lender to the borrower. The lender, on the other hand, will retain the benefits of lending to the high risk borrower by charging the high interest which typically third tier loans incur. The lender can still use the WG term however, if the lender is able to show that the term is “reasonably necessary” to protect its ‘legitimate interests’, being the second consideration under the FTA in determining whether a term is unfair.<sup>340</sup>

**c. Reasonably Necessary to Protect a Legitimate Interest**

To begin, there is a presumption that the term is not reasonably necessary in order to protect a legitimate interest.<sup>341</sup> This has the effect of placing the evidential onus of justifying the term as necessary and fair with the lender.<sup>342</sup> The Commerce Commission has stated that given the purpose of the Act, this provision places a high threshold on parties seeking to rebut the contrary presumption. Their view is that a party would need to establish that the interest being protected by the term is 1) a legitimate interest that requires protection, and 2) it cannot reasonably be protected by fairer means.<sup>343</sup> This indicates there are two stages to the relevant inquiry.<sup>344</sup> The first stage is to ask whether the term protects a legitimate interest of the lender. This requirement might be satisfied by showing that the term protects the lender from risks inherent to borrowers with poor credit ratings. It is likely this evidence can easily be obtained by the lender, as previously stated, generally third tier borrowers have histories of financial delinquency with high risks of default. The lender can also easily show that a business which lends money, but does not get it back, will not stay in business long. It can be then concluded that the WG term will protect against this inherent business risk of lending to risky borrowers. However, it is the second stage of the test which is crucial to the reasonableness of the WG term.

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<sup>340</sup> Section 46L (1)(b) of the FTA.

<sup>341</sup> Section 46L (3) of the FTA.

<sup>342</sup> It was noted in *Gowan v Hardie* [1991] NSWCA 126, BC9102718, that a lack of information concerning the supplier's legitimate interest restricts the extent to which the court can engage in a substantive analysis of a contractual term and hence the lack of information will be at the supplier's disadvantage. This is justified by the supplier being best placed to provide information concerning their legitimate interest.

<sup>343</sup> NZCCDUT, above, at n 313, page 13, [59].

<sup>344</sup> Paterson, above at n 3, 944.

The second stage is to consider whether the term is reasonably necessary to protect the lender from the risk of default by the borrower. Reasonably necessary connotes that the term must be proportionate to the interest being protected,<sup>345</sup> so the lender must show that the term is not only an effective response to the risk, but a proportionate response.<sup>346</sup> Paterson suggests in commenting on the Australian equivalent section that in applying the test of proportionality it must be considered “whether the term is an attempt by that party to respond to risks inherent in the transaction, as opposed to an opportunistic attempt to appropriate gains not contemplated as part of the original bargain.”<sup>347</sup> Where it appears that the term not only protects the interest, but grants additional advantages to the lender at the borrowers expense, the inquiry into whether the term is proportionate may require considering other possible ways of protecting the lenders interests that would be both less burdensome to the consumer,<sup>348</sup> and also less advantageous to the lender.<sup>349</sup> This will of course only become an issue if there are other options available. Where there are no other options available it may be found that despite a lack of proportionality, the term is still necessary.

In order to justify that the WG term is a proportionate response, a lender may argue that substituting the WG term with another term would require them to 'bear a disproportionate

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<sup>345</sup> Ibid, at 945.

<sup>346</sup> In *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482, a term in a mortgage agreement increased a mortgagee's security to an unlimited amount, rather than simply substituting the existing security. Groves J at first instance found both procedural and substantive unfairness in the extension of the security to an unlimited amount, and the decision of the Court of Appeal reproduced the following reasoning from the first instance decision: 'the legitimate interest of *Esanda* was to replace the security they had from the [former mortgagor]. They obtained an excess from the [subsequent mortgagor]', per Handley JA, at 488. This part of Groves J's reasoning demonstrates the focus on the substantive fairness of the term as a disproportionate response to the supplier's legitimate interest. In contrast to this, in *Gowan v Hardie*, above n 342, a contract for recreational parachuting services that excluded liability for negligence on the part of the operator and its agents was upheld as enforceable. In that case, certain procedural factors were relevant to the court's assessment, including the fact that the consumer approached the supplier for training and the forms had been explained to the consumer. On appeal, the court agreed that the clause protected the supplier's legitimate interest in providing a dangerous recreational activity at a modest cost.

<sup>347</sup> J Paterson, 'The elements of a prohibition on unfair terms in consumer contracts' (2009) *Australian Business Law Review* 184, at 193.

<sup>348</sup> Paterson, above n 3, at 945.

<sup>349</sup> It has been suggested that private insurance against the risk that a borrower poses is the most efficient and fair way for a trader to protect itself and the trader should not be able to pass their risk onto the consumer. See Chin, above n 31. However, although this is a sensible solution in theory, the practical implications of this may mean that many users of payday lenders would not be eligible for any loan at all as they would pose an unacceptable risk to the insurance company.

higher level of contractual risk or obligation than the borrower'.<sup>350</sup> Conversely, the WG term must also equally show that the term does not impose upon the borrower a higher level of contractual risk than the lender. It would seem that with the use of the WG term there is very little risk at all placed on the lender. In order for the lender to be out of pocket it would require not only for the borrower to default, but also extinguish all funds from their bank account, and the borrower must also suddenly lose their job or any other means of income. Given the short term nature of PLs, this seems a low level risk. On the other hand, if the borrower finds their situation has suddenly changed and will have difficulty repaying their loan, this risk will be theirs alone to bear. It would seem that the effect of this term makes the risk fall more heavily upon the borrower, so may challenge being reasonably necessary.<sup>351</sup>

In determining the question of reasonably necessary it will also be relevant to consider whether the interest is already being protected elsewhere in the contract.<sup>352</sup> In most PL SFCs there is also a term which requires the borrower to sign a direct debit authorisation. This term allows the lender to withdraw funds from the borrower's bank account, rather than garnish the funds directly from wages. This however may not be a useful recovery tool, as all the borrower needs to do is withdraw their funds in cash prior to the debit being charged. There is also the risk that the borrower has multiple direct debits, and the lender's direct debit falls after the others.

Another question to consider is whether it is even fair to protect the lender fully from the risks inherent in the contract. If the lender is in the business of lending money to third tier borrowers, it would follow that this would carry a portion of risk, which is represented in the high interest rates that these loans incur. Further, it could be argued that it would be reasonable for the lender to burden that portion of risk, since the borrower is being given the burden of the high interest rates. For borrowers who are found to be extremely risky, the lender ought to protect themselves by not lending to these borrowers. This is how first and second tier lenders protect

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<sup>350</sup> Zumbo, above n 79, at 73.

<sup>351</sup> Sims, above n 43, at 769.

<sup>352</sup> In *Kowalczyk v Accom Finance Pty* [2008] NSWCA 343, (2008) 77 NSWLR 205, the New South Wales Court of Appeal acknowledged that lenders have a legitimate interest in recovering their costs in the event of a default by a borrower, at [174]. However, it was also noted that where that legitimate interest was protected elsewhere in the loan agreements by express provisions for the recovery of costs, additional terms providing for an escalating rate of interest in the event of default were not reasonably necessary for the protection of that legitimate interest, at [166].

their legitimate interest in seeing a return on their loans. The PL industry cannot state that they are required to lend to all. They simply choose to. Therefore, they cannot argue that for some extremely risky borrowers the WG term is a necessity, as they would not need the WG term at all if they protected themselves through being more selective.

Rather than payday lenders continuing to work inside their business module of almost complete inclusivity of all borrowers, it might be time to adjust their strategy. If a payday lender then chooses to lend to what they would consider a high risk borrower regardless, it would then be unfair for the lender to exclude all liability from itself by the clever use of a term like the WG term. Where you take a risk, it is fair that you bear the cost of that risk if it eventuates. The Commerce Commission has identified in their reviews of the telecommunications<sup>353</sup>, gyms<sup>354</sup> and energy providers<sup>355</sup> that potentially unfair terms are terms which seek to limit or exclude liability which cannot fairly be excluded. It may be that the WG term does precisely that.

#### **d. Detriment**

The final consideration for the determination of unfair terms requires the Court to be satisfied that the term would cause detriment, whether financial or otherwise, to a party if it were applied, enforced, or relied on.<sup>356</sup> For this consideration the use of the word ‘if’ suggests that the Court would not have to establish that detriment has occurred due to the term.<sup>357</sup> It would instead suffice to only show that a term has the potential to cause detriment.

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<sup>353</sup> Commerce Commission, *Telecommunications Contract Review: Unfair Contract Terms*, February 2016 <<http://www.comcom.govt.nz/the-commission/consumer-reports/uct-reviews/>>

<sup>354</sup> Commerce Commission, *Gym Contract Review: Unfair Contract Terms*, August 2017<[https://www.comcom.govt.nz/data/assets/pdf\\_file/0020/86123/Unfair-contract-terms-Gym-contracts-review](https://www.comcom.govt.nz/data/assets/pdf_file/0020/86123/Unfair-contract-terms-Gym-contracts-review)

<sup>355</sup> Commerce Commission, *Energy Retail Contract Review: Unfair Contract Terms*, August 2016<[https://www.comcom.govt.nz/data/assets/pdf\\_file/0019/86122/Unfair-contract-terms-Energy-retail-contracts-review](https://www.comcom.govt.nz/data/assets/pdf_file/0019/86122/Unfair-contract-terms-Energy-retail-contracts-review)

<sup>356</sup> Section 46L(1)(c) of the FTA.

<sup>357</sup> Paterson, above n 3, at 945.

Other jurisdictions with equivalent legislation have found that this consideration should easily be satisfied,<sup>358</sup> however it is important to note that the potential detriment must be more than just a hypothetical risk.<sup>359</sup> In the case of the WG term, lenders have described the effects of this term as irrevocable. It has been warned by the Commerce Commission that such a statement is misleading to the consumer's rights under the WPA,<sup>360</sup> and such a statement may satisfy the detriment consideration alone.<sup>361</sup>

#### e. Transparency

In order to understand what the consideration of transparency will require, the UK High Court case of *Office of Fair Trading v Abbey National plc* (before it was appealed to the Court of Appeal and Supreme Court) may be helpful regarding how the term 'transparent' may be interpreted. Here in the High Court it was stated per Smith J that: "[Transparency]<sup>362</sup> requires not only the actual wording of individual clauses or conditions be comprehensible to consumers, but that the typical consumer can understand how the term affects the rights and obligations that he and the seller or supplier have under the contract."<sup>363</sup>

New Zealand has not included a definition of transparency within its legislation, however the Australian legislation has defined a term as transparent if it is:

(a) expressed in reasonably plain language; and

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<sup>358</sup> In *First National Bank* [2002] 1 AC 481, at 499, Lord Steyn stated that the 'element of detriment to the consumer may not add much', but noted its instrumental use in guiding the interpretation of the test of unfairness as 'aimed at significant imbalance against the consumer, rather than the seller or supplier', at [36].

<sup>359</sup> In Australia, The Explanatory Memorandum to Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010 para 5.31 has described the element of detriment as requiring 'more than a hypothetical case to be made out by the claimant'. By contrast under the original draft of the Bill, the test was drafted so that the term only had to give rise to 'substantial likelihood of detriment'. See Trade Practices Amendment (Australian Consumer Law) Bill 2009, s 3(20(a)).

<sup>360</sup> Stock, above, at n 291.

<sup>361</sup> Under the Victorian legislation, in *Jetstar* [2008] VSC 539, Cavanough J noted that an enforceable promise or statement made by the supplier to imply an effect of a term being binding, but actually unenforceable or valueless is the kind of thing that any conventional understanding of contrariety to good faith might cover. It was noted that what is contrary to good faith towards the consumer will likely also be detrimental.

<sup>362</sup> The unfair contract provisions in the United Kingdom use the phrase 'plain and intelligible language' rather than 'transparent', however the practical effect of these two phrases is likely to be the same.

<sup>363</sup> [2008] EWHC 875 (Comm) (24 April 2008) [103].

(b) legible; and

(c) presented clearly; and

(d) readily available to any party affected by the term.<sup>364</sup>

From the onset it would appear these factors relate to the process of forming the contract, rather than the substance of the terms, and this consideration of transparency seems somewhat of a step backwards from the progression of substantial protection.<sup>365</sup> Whether the terms of a SFC are transparent, or whether the trader has provided consumers with sufficient notice about the terms of the contract so that the conditions for relatively informed consent by the consumer have been met, is very much an issue of procedural protection.

Although being transparent is something all traders ought to be, it has very little to do with the substance of the terms they use in their SFCs. Tokeley explains that incorporating the idea of transparency into the test for the substantive unfairness of these terms is problematic in two ways. First, it creates uncertainty and confusion by mixing up concepts of substantive and procedural fairness, which Tokeley suggests require separate consideration. Second is the danger that the substantive protection might be interpreted by the courts as meaning an otherwise imbalanced, disproportionate and unfair term will no longer be unfair under the legislation so long as the supplier can show that the term was highly transparent.<sup>366</sup> This creates a real risk that comprehensive transparency might be taken to outweigh arguments regarding substantive unfairness.<sup>367</sup>

The justification for substantive protection proceeds on the premise that transparency is not enough to provide sufficient protection to consumers. Even where terms are relatively transparent in the sense of being displayed in a prominent position and expressed in clear

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<sup>364</sup> Australian Consumer Law section 24(3).

<sup>365</sup> Tokeley, 'A Critical Analysis of the Current Proposal', above n 323, at 126 -127.

<sup>366</sup> *Ibid*, at 127.

<sup>367</sup> In *Director of Consumer Affairs Victoria v Train station Health Clubs Pty Ltd* [2008] VCAT 2092 (Civil Claims) in describing an unfair term Harbison J held at [145] that: '[an unfair term] is a term which in my view would surprise consumers. It is one which they would not expect. However, I can envisage that such a term might be perfectly fair if it was brought to a consumer's attention prior to signing of a contract. This suggests that a trader may overcome an allegation that a term is unfair by establishing that the term was transparent. In the United Kingdom under the UTCCR 1999 it remains unclear from the decision in *First National Bank* whether a term that is transparent, or in 'plain and intelligible language', can legitimise a substantially unfair term.



language, often they will not influence consumers' decisions to enter into the contract.<sup>368</sup> Payday lenders have defended their use of the WG term mainly by arguing that they fully explain the term to their borrowers.<sup>369</sup> The emphasis placed on this point is possibly due to the danger that the term is unusual and is of potential high risk to the borrower.<sup>370</sup> However, as has been stated, where other factors are at the forefront of the borrower's mind, little attention is likely to be given to an explanation of a non-salient term. It has been submitted that *how much* and *when* will likely be the salient factors to the borrower, so if the borrower has already made up their mind that they will accept the contract based on the salient terms being satisfied, there is no incentive for a borrower to listen to any such explanations.

The New Zealand legislative provisions however are clear that transparency is only one factor in the balancing exercise, and is not the determining factor as to whether a term is unfair.<sup>371</sup> A leading Victorian authority also suggests that transparency on its own account cannot overcome underlying unfairness in a contract term. In *Jetstar Airways Pty Ltd v Free*, Cavanough J expressed the view that, depending on all the circumstances, a term might be unfair notwithstanding full prior knowledge on the part of the consumer. Referring to the former Pt 2B of the Fair Trading Act 1999, His Honour stated: 'The legislation proceeds on the assumption that some terms in consumer contracts, especially in standard form consumer contracts, may be inherently unfair regardless of how comprehensively they might be drawn to the consumer's attention'.<sup>372</sup>

Despite this, with transparency as a consideration, there is a real danger that courts may still interpret the lender's extensive notice of a term as an overly mitigated factor in favour of the

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<sup>368</sup> *Jetstar*, above n 361, at [115].

<sup>369</sup> *Stock*, above at n 291.

<sup>370</sup> Courts have suggested that, where the terms to be incorporated into the contract are unusual, special notice, such as will fairly and reasonably bring the terms to the attention of the party to be bound, must be given. See *OFT v Foxtons* [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133 [92]-[94].

<sup>371</sup> Section 46L (2) of the FTA; Also, the Explanatory Memorandum from Australia, above n 358, at [2.45-2.46] states that a lack of transparency in the consumer contract will be a 'strong indication of a significant imbalance', but transparency alone 'cannot overcome unfairness in a contract term', at [5.39]; Willett, above at n 331, at 373 examines the tension between procedural and substantive elements of the UTCCR 1999 and the Australian Consumer Law and concludes that it was the legislative intention in drafting the Australian Consumer Law to impose standards of substantive fairness that could not be satisfied by demonstrating transparency in the bargaining process.

<sup>372</sup> *Jetstar*, above, at n 361, at [115].

lender. The purpose of unfair terms legislation should be to move beyond the idea that a transparency or disclosure mitigates inherent unfairness. The reason that legislation is required is that rational consumers will not read the non-salient terms of SFCs irrespective of transparency.<sup>373</sup> If transparency was the problem we would not need unfair terms legislation.<sup>374</sup> It is submitted that the consideration of transparency adds nothing to protecting the borrower, but instead, to the advantage of the lender, attaches uncertainty.

#### **f. Contract as a Whole**

In considering the contract as a whole, a court will often need to balance the legitimate commercial interests of the business against the detriment the term would cause to a consumer if it were enforced. It has been noted that certain terms may sometimes appear to be unfair, however depending on the business, the use of such terms may be needed to keep their costs at such a level that the good or service is affordable to the consumer.<sup>375</sup> In such circumstances, the use of a term to manage risk and minimise cost may be viewed by a court as unfair, yet necessary and acceptable.

Where a potentially unfair term is necessary, it would follow that the party burdened by it ought to receive something of value in return. This essentially equates to assessing whether the contract as a whole is balanced. In determining this, Cavanough J in *Jetstar* noted that the Victorian Legislation required the examination of both rights and obligations of the parties. He found this required the Court to consider that any detriment to a consumer from a particular term must be weighed against any countervailing benefits rather than consider it in isolation.<sup>376</sup> This may mean that a potentially unfair term may be included in a consumer contract if it is counterbalanced by additional benefits, such as a lower price being offered to the other party. By this, for a price reduction to counterbalance the effect of an otherwise unfair term, it must

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<sup>373</sup> M Chen-Wishart, 'Transparency and Fairness in Bank Charges' (2010) 126 *Law Quarterly Review* 157, at 160.

<sup>374</sup> Tokeley, 'A Critical Analysis', above n 323, at 127.

<sup>375</sup> See Tokeley, *ibid*, 128. "Some harsh terms are in fact necessary in order for the contract to be feasible. For example, a bank that lends to a high risk borrower needs a term that provides them with a high level of security. Banning this type of harsh term might not result in these contracts being re-written with more lenient terms. The outcome might instead be that these contracts are no longer available and it becomes impossible for low income consumers to get access to loans."

<sup>376</sup> *Jetstar*, above n 361, at [129].

be shown that the low price can be related to the term and not to another feature of the contract.<sup>377</sup> The reduction in price must also be proportionate to a term that gives a significant advantage to the supplier or places an onerous burden on the consumer.<sup>378</sup> It would seem however in the case of PLs where the interest rates and cost of credit are still the highest in the credit market despite the recent caps, there appears to be no price reduction on the loan for the inclusion of the WG term. Further, as has been mentioned, there is never an option for the borrower to remove the term in exchange for a higher interest rate.

### **g. Other Possible Considerations**

It is difficult to predict which considerations a court may find relevant in its assessment of unfairness, but public interest, which is not expressly referred to as a factor to be considered, has been addressed by the courts as being relevant in some cases.<sup>379</sup> It could in time be a considerable consideration or even the paramount consideration if the use of the WG term escalates in its abuse in response to the payday lending industry not being able to survive well in the future due to the cost of credit caps enforced by the CCLAA.

As has been suggested, wage garnishment does, and will continue to, cause harm to PBs. In the general sense of the concept of unfairness, how lenders use this as a tool to recover debt would likely meet that definition. With the enactment of the CCLAA, this general unfairness will not only continue, but likely increase. Under the FTA however, it will likely not meet this definition of unfairness. Although probably close to 90% of the definition is met, where it falls short is that it will likely be found to be reasonably necessary in favour of the lender. There are limited options when it comes to guaranteeing an unsecured loan is repaid, especially when the borrower has no savings and is on a low income. For this reason wage garnishment may likely

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<sup>377</sup> *Australian Competition and Consumer Commission v CLA Trading Pty Ltd* [2016] FCA 337 at [54].

<sup>378</sup> See H de Kock, 'Unfair Contract Terms under the Australian Consumer Law', September 2016; However, in *Director of Consumer Affairs Victoria v Blackloads.com Pty Ltd* (Civil Claims) [2009] VCAT 754 at [211], Harbison J held that the 'argument that the respondent offers a cheaper service to consumers, even if accepted, cannot be used to justify this clause, or neutralize its obvious unfairness'.

<sup>379</sup> In *Kowalczyk v Acomm Finance Pty Ltd* [2008], above n 352, at [166], Campbell J impugned the legitimacy of the lender's interest as contrary to the public interest.

be found to be fair simply because there is no other way to protect the interest. Although this seems a weak justification to uphold the term, under the provisions it is likely enough.

The Australian decision *Paciocco v ANZ*<sup>380</sup> which emphasised on the necessity of commercial legitimate interests within the terms of SFCs is likely a good indication of how the WG term will be viewed under the provisions. *Paciocco*, which involved the use of terms which allowed the enforcement of late penalty fees, found that Courts will be reluctant to interfere with contractual provisions of this kind and will take a broad view as to the legitimate commercial interests which the provision seeks to protect. Gageler J held that, in light of ANZ's commercial interests of ensuring observance by its customers of meeting due payment, provisions which protect this may be justified by reference to a broad range of legitimate commercial interests.<sup>381</sup> It was noted also that the enquiry need not be confined to the consequences which may follow from one isolated breach by one customer. This indicates that potential harm alone that the borrower may suffer will likely not meet the judicial threshold.

Also in *Paciocco*, Allsop CJ stated that 'the provisions were clearly disclosed. In most instances, the fees could be avoided. No trickery took place...and the fee could be avoided by the conduct of the customer that was not unreasonable'.<sup>382</sup> This appears to indicate that there may be balancing to consider when there is a burdensome legitimate interest which needs to be protected compared to a detriment. In *Paciocco* there is an indication that even if the risk of detriment is severe, if it can be avoided by reasonable action then the legitimate interest will be favoured. This is especially so if the risk of detriment is made objectively and reasonably clear. Although this may be sufficient for the general consumer, it is likely that this approach will lead to harm for the PB if relied on.

In identifying the vast reasons for the WG term's unfairness, yet not meeting the definition, it is suggested that the application of the provisions ought to be reassessed. It is suggested that in order to achieve the objectives of the provisions in preventing unfairness, rather than requiring

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<sup>380</sup> *Paciocco v Australia & New Zealand Banking Group Ltd* [2016] HCA 28.

<sup>381</sup> *Ibid*, at [169]-[177], per Gageler J.

<sup>382</sup> *Ibid*, at [301]

the judicial threshold of all components of an unfair term being sufficiently met, a better and more fairer approach would be to take a more over-all and holistic approach to its definition.

Even if the unfair terms provisions were amended however to prevent payday lenders from relying on the WG term, or if restriction were put in place to limit the terms use, the borrower would still not be benefitted overall. With the CCLAA in place restricting the total cost that can be recouped on a loan, as discussed, it is precisely the existence of the WG term which keeps payday lenders providing the only credit available to PBs. With no alternative credit yet available, the goal is to not completely exclude these borrowers from all credit, but to assist in facilitating a price for credit which is objectively fair to both the borrower and the lender.

If this is achieved, the use of the WG term would likely decrease, as the WG term is essentially there to protect the lender from the unfairness that may occur to them should the borrower not pay the agreed price. It is submitted then that establishing and enforcing a fair price for credit is the crucial element to achieving effective and workable consumer credit protections for PBs, rather than concentrating on maximum limits, which has often been the focus in dealing with this problem. This section now turns to the unfair terms provisions within the FTA concerning price and the exemptions to challenges of unfairness under the provisions.

#### **(iv) Exemptions to the FTA Unfair Terms provisions**

Under the FTA, there are certain terms which despite however objectively unfair they may be in a particular circumstance, they cannot be challenged or examined for unfairness.<sup>383</sup>

Section 46K of the FTA sets out three categories of terms that are exempt from consideration under the unfair terms provisions. Section 46K of the FTA states that;

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<sup>383</sup> Section 46K of the FTA.

(1) A court may not declare a term in a standard form consumer contract to be an unfair contract term to the extent that the term—

- (a) defines the main subject matter of the contract; or
- (b) sets the upfront price payable under the contract; or
- (c) is a term required or expressly permitted by any enactment.

As for the main subject matter of the contract, being the goods or services that are being supplied, the exemption from considerations of fairness makes sense, as the subject matter will likely be at the forefront of the consumer's mind and subject to much greater scrutiny than the other terms of the contract.<sup>384</sup> Terms that are expressly permitted by law are also naturally excluded. The final exclusion, being upfront price ("UP") or price payable under the contract, is an exempted term which this thesis argues as not being as straight forward in its justification for exemption. Australia and the United Kingdom also include UP as being excluded from the operation of the test of unfairness within their unfair terms provisions. With New Zealand adopting large portions of their unfair terms provisions from these jurisdictions, it was unsurprisingly that New Zealand followed their predecessors with including the limitation of excluding terms that define UP. In each three of these jurisdictions the general reasons for allowing this exemption of UP are similar.

#### **a. General Justification for Upfront Price Exemption**

The ultimate purpose of the unfair terms provisions is to promote fairness.<sup>385</sup> Although legislation's main concern in enacting the provisions was the well-being of consumers, the supplier (or stronger party to the contract) must not be forgotten. In fairness to the supplier, legislation should not intervene to the advantage of the consumer where it is not needed and if it is to the detriment of the supplier. Unfair terms legislation can be justified as necessary due

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<sup>384</sup> This rationale for the exclusion of terms which define the subject matter of the contract was given in Treasury, Australian Government, *The Australian Consumer Law: Consultation on Draft Provisions on Unfair Contract Terms* (2009), at 15.

<sup>385</sup> The Australian Productivity Commission observed '[t]he strongest argument for [regulation] is ethically based — and is merely the extension of existing ethical principles about fairness in contracts, to cover substantive terms that appear to be manifestly unfair in most circumstances'. See Productivity Commission, Australian Government, 'Review of Australia's Consumer Policy Framework' (Productivity Commission Inquiry Report No 45, 30 April 2008) vol 2, at 151.

to a market failure consequential to consumers routinely not examining terms they agree to. Conversely, if there is no market failure, due to it being proven that a certain term in a contract is routinely examined by consumers, then there is no justification for intervention.<sup>386</sup> Further, the justification for increasing uncertainty in contract law by replacing terms in a consumer contract with other terms considered as more fair by a court, government agency or another third party, is based on the consumer not actually being aware of the terms.

With the UP of a contract for the sale and purchase of a product or service, often the consumer will be fully aware of the price of the product or service. They will then willingly and consciously agree to that price when entering the contract agreement for it. It can be said that a term is willingly and consciously agreed to if the term is an "examined term". An "examined term" is defined as any term that is considered important enough to make it rational for consumers to read it and take it into account in making the purchasing decision.<sup>387</sup> Academic writers have also referred to this kind of term as "visible",<sup>388</sup> "salient"<sup>389</sup> or "core".<sup>390</sup>

For this reason, unfair terms legislation has acknowledged that for all examined terms intervention is not needed,<sup>391</sup> so the unfair terms protection ought not extend to them. This seems uncontroversial, as it would be contrary to general contract law to allow parties to a contract to challenge terms which have been given due consideration and have been easily understood.<sup>392</sup> The Victorian legislation, which was a predecessor to the Australian unfair terms legislation, did not provide for this in their provisions for unfair terms, allowing all terms in SFCs to be scrutinised for fairness. This is perhaps a flaw in the Victorian legislation, as not

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<sup>386</sup> Tokeley, 'Introducing a Prohibition on Unfair Terms into New Zealand Law: Justifications and Suggestions for Reform' at 432.

<sup>387</sup> Tokeley, 'A Critically Analysis of the Current Proposal', above n 323, 116.

<sup>388</sup> T D Rakoff, 'Contracts of Adhesion: An Essay in Reconstruction' (1983) 96 *Harvard law Review* 1174.

<sup>389</sup> R Korobkin, 'Bounded Rationality, Standard Form Contracts, and Unconscionability' (2003) 70 *University of Chicago Law Review* 1203.

<sup>390</sup> R Brownsword and G Howells, 'The Implementation of the EC Directive on Unfair Terms in Consumer Contracts- Some Unresolved Questions' (1995) *Journal of Business Law* 243, at 247.

<sup>391</sup> The rationale for this is that examined terms will form part of the consumer's purchasing decision so normal workings of the market can operate effectively and provide protection to the consumer. See Tokeley, 'A Critical Analysis of the Current Proposal', above n 323, at 116.

<sup>392</sup> Standing Committee of Officials of Consumer Affairs, Parliament of Australia, *An Australian Consumer Law: Fair Markets — Confident Consumers* (2009) <http://www.treasury.gov.au/contentitem.asp?ContentID=1484&NavID=037> ('*Australian Consumer Law Report*'); Treasury, Australian Government, above, n 384, 15.

allowing exemptions where the terms are examined clearly goes against the justification for the legislation.

### **b. Price as an Examined Term**

The general argument that UP ought to be treated as an examined term is because the average consumer is expected to read and understand the price of a product or service, and then allow the price to influence their decision to purchase.<sup>393</sup> This is premised on two factors. First, the price is of sufficient importance to all consumers that it ought to always be a salient term when making the decision to enter the contract.<sup>394</sup> Second, that the total price of the contract is a term that the consumer can easily understand and will seldom be an unfair surprise.<sup>395</sup> With these two factors present, to disallow the exemption would allow consumers to take advantage of the unfair terms legislation. In such a case, the consumer would be able to make an informed choice in relation to this component of the bargain, yet still be able to challenge the component should the bargain not be ultimately beneficial to the consumer.

In general terms then, this exemption makes sense. Usually one of the first factors that a consumer examines when deciding upon a product is the price, as this is a main factor used for comparing similar products. Also, price usually is clearly stated in a predominate place alongside the product, making it clear and easy to understand. Suppliers rely on price being easily accessible and easily understood in order to attract customers and maintain business. It would then usually not be in a supplier or a business' interests to make this term confusing.

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<sup>393</sup> In Australia The Explanatory Memorandum to the ACL, above at n 358, at [5.67].

states that: "Having agreed to provide a particular amount of consideration when the contract was made, which was disclosed at or before the time the contract was entered into, a person cannot then argue that that consideration is unfair at a later time. The upfront price is a matter about which the person has a choice and, in many cases, may negotiate.

<sup>394</sup> See Treasury, Australian Government, above, at n 384, at 15; *Australian Consumer Law Report*, above at n 225, 34; Although academics such as Alexandra Sims, see Sims, above n 43, at 760, and Paterson; See Paterson, above n 3, 942, agree with this premise and argue that this single term regarding price is of such significant importance that purchases, regardless of the type of contract or the particular consumer, will be made based on this term alone, this paper submits that the price of a contract will often be of significant importance, but not always. It is submitted that in the case of third tier borrowing, the total price payable will often not be significant enough to the borrower for the price to be a salient term.

<sup>395</sup> Farnsworth, A E, *Farnsworth on Contracts* (2<sup>nd</sup> ed, Aspen Publishers, New York, 1998), at 329.



For most consumer contracts, this exemption of UP from challenges of unfairness would be fair. However, in the case of the general consumer using a PL SFC, it is suggested that it may not be fair. Further, in the specific case of a PB as a class of consumer using a PL SFC, extreme objective unfairness remains highly likely with UP being exempt from challenges of unfairness. It is submitted that the current credit consumer protection laws in place in New Zealand are insufficient to adequately protect the PB in regards to price when contracting for credit under a PL SFC, and it is now suggested that the best way to protect the PB is to amend the unfair terms provisions to remove the UP exemption in the case of PL SFC. The next section of this paper will give the justifications for this.

## SECTION FOUR

### ***6. Upfront Price as an Unfair Term***

The New Zealand legislation under section 46K (2) of the FTA, defines UP as the consideration (including any consideration that is contingent upon the occurrence or non-occurrence of a particular event) payable under the contract, but only to the extent that the consideration is set out in a term that is transparent. It is likely that this definition of UP also includes future payments or a series of payments, provided that they are disclosed at or before the time the contract is entered into.<sup>396</sup>

The unusual, or controversial, element to this definition of UP is the inclusion of ‘any consideration that is contingent upon the occurrence or non-occurrence of a particular event’, as this element of the definition causes UP to become a contingent concept, rather than a fix concept. It is the inclusion of this factor within UP which may cause the UP to become an objectively unfair component within certain SFCs, which may cause the deal itself to be objectively unfair. This section will investigate whether, or to what degree, objective unfairness resides within PL SFCs due to the current New Zealand unfair terms provisions preventing UP from being challenged for unfairness. This section will also investigate whether PBs are

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<sup>396</sup> In this regard, the Explanatory Memorandum to the ACL, above at n 358, at [5.67] states that: ‘A key consideration for a court in considering whether a future payment, or a series of future payments, forms the upfront price may be the transparency of the disclosure of such payment or the basis on which such payments may be determined, at or before the time the contract is made.’

especially susceptible to unfairness from the UP exemption and whether there is a justification for PBs as a class of consumer to be excluded from the UP exemption when using PL SFCs.

### **A. Upfront Price as a Contingent Concept**

Within the typical PL SFC, the total price payable under the contract can be difficult to determine. It has been stated that one of the main reasons for this is price bundling, which involves the inclusion of contingency fees such as default fees, default interest, and other added costs which are activated through some future event. In the case PL SFC, the total contingent price of these contracts will not be fully examined, so the UP under the SFC will not be treated or used in the same way by the general consumer as it would be under other consumer contracts where the price is easier to determine. This has the effect of the general consumer not being capable of protecting themselves to the same degree as with other consumer contracts.

If the price is then exempted from challenges of unfairness on the assumption that the general consumer has the same self-protection abilities using PL SFCs as other consumer contracts, then there is a risk of unfairness. In this case, it is not strictly the PB as a class of consumer who is vulnerable to unfairness from the exemption, as the general consumer would likely also face the same difficulty in deciphering the actual price under the loan.

As has been previously stated, the general UP exemption is premised on two assumptions. The first is that it will be of sufficient importance to the consumer and the second is that UP will be easily identifiable and understood. It is submitted that although these assumptions are generally present when the UP is a fixed concept, neither of these assumptions are present when the UP becomes a contingent concept.

### (i) **Price as a Comparable Term**

As for the first assumption, a major reason price will usually be one of the most important and carefully examined factors to the general consumer is because it is useful in aiding the consumer to making optimal decisions. As has been established, making optimal decisions when contracting for goods and services will often involve ‘shopping around’ to compare the different suppliers of the desired goods and services. Since this can be both a difficult and time consumer task, it is natural for consumers to search for ways to make this task easier and quicker.

One predominate way in which consumers attempt to achieve this is by focussing primarily on the price of a product or service. This is because the average consumer through experience realises that fast and easy comparison of similar goods and services is not only possible, but also often effective through the use of price comparison alone. Since reduced time and resources from focusing on one particular factor can achieve the consumer’s goal of comparison, the consumer, either consciously or otherwise, identifies price focussing as a cost-effective means of getting the best value for money. This ease and speed of price comparison has in fact elevated price to become one of the most predominate factors in consumers decision-making.

However, this usefulness in ease and speed which price comparison presents to the consumer relies on the price being allocated a narrow definition to present price as a definite, or a constant. In this way, price can be said to be fixed. However, if the definition of price becomes widened due to its composition including the addition of contingencies, it is no longer fixed, a definite or a constant. It instead becomes a variable. Generally, the more contingent or variable, as opposed to fixed or definite a concept, the more time and resources will be required to establish its true or real meaning. This then makes the concept more difficult to be used for comparison. Therefore, when price as a concept shifts from a constant to a variable, it loses its usefulness of being easily and quickly comparable, and ultimately a less cost-effective means for the consumer to ensure their value for money.

With UP as it is currently defined in the New Zealand unfair terms provisions, assigning an UP to particular products and services as a monetary value will often be very difficult. In line with that difficulty, UP will reduce in its importance to the average consumer.<sup>397</sup> As has been established in Section One, when consumers have many factors to consider, the less important factors are ignored in favour of the factors the consumer regards as most important. The result, as has been suggested, is that these less important factors are often not examined at all.

With the New Zealand definition of UP being highly contingent and conceptually wide of a concern, it is likely that UP will be stretched to become inclusive of factors which, although are associated with price, in the realistic view of the general consumer will be recognised as low probability risks. As previously established in Section One, research in behavioural economics suggest it is unlikely that the average consumer will pay close attention to low probability contingency costs, despite them being associated with price. It would then be an unrealistic assumption on the general consumer for these perceived low probability contingency risks, which are included in the definition of UP, to retain sufficient importance to the consumer for it to be routinely examined.

Since the perceived low probability risks within the contingency costs cannot be separated from the UP, the UP alters perception in its entirety from being the actual price of a product to a low probability risk. In Section One of this paper it has been suggested that usually the lower the probability of the risk, the greater the probability of the risk being ignored. Therefore, the lower the perceived probability of the contingency cost risks, the less the likelihood of UP being examined and the less the ability for UP to be considered a part of the exceptional category of ‘examined terms’. Instead, UP will become a part of the ‘unexamined terms’ category, which falls within the justification for the term to be challenged for unfairness.

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<sup>397</sup> An example of this buying a cellular phone through contract. In the past few years it has become more and more difficult to establish the actual UP of purchasing cellular phones through contracts. The result of this is that the consumer’s primary focus for comparison has moved from price to other factors within the contract plan. Such factors include replacement insurance, security, international options, network coverage, length of contract, customer service and the company’s reputation.

Even if the risks which make up UP are not completely ignored, they will be of little use unless the consumer fully understands them. To expect consumers to understand such risks places unrealistic and unreasonable assumptions on the consumer's ability to predict future events. As has been established, consumers tend to undervalue and disregard risks where they are future risks and are not familiar risks. Where the risks within the UP are misunderstood, it is in fact the UP itself which is misunderstood.

## **(ii) Price as an Identifiable Term**

The second assumption upon which the general justification for UP exemption is premised is that price is easily recognised. When contingencies are included in forming the UP, this second assumption also becomes controversial, and hence causes difficulties in conforming to the general justification. The first problem with this second assumption stems from the inability of consumers to accurately recognise UP. Although most consumers will search to identify a price before they decide upon a product or service, they may not necessarily correctly identify the UP as defined in the FTA. This is especially so if the average consumer's concept of price does not equate to that particular definition.

For a factor to be recognised by the general consumer, which is the target anticipated by the unfair terms provisions, it must then be presented in a way that is familiar to the general consumer. When UP is then the factor, for the general consumer, it is the natural meaning of price which will likely be most familiar, and hence recognised to be UP. The problem then with including contingency payments within the UP is that it stretches the natural meaning of price too far. One reason that the general consumer may have difficulty equating their natural meaning of price with an UP that is inclusive of 'any consideration that is contingent upon the occurrence or non-occurrence of a particular event' is because UP becomes overly inclusive.

It is likely that the average consumer would not consider, for example the price of a car, to include the eventual cost of all and any fees associated with not being able to make the part payments on the car in time. The consumer would likely exclude such fees and contingencies

and simply look exclusively at the price on the car and assume that is the UP. Since the natural meaning of price is inherently exclusive, when price attempts to adopt an inclusive definition the result will be that elements of the definition may be overlooked, leading to some non-examined terms associated with price being incorrectly defined as examined terms.

### (iii) **Further Considerations**

In addition to ‘any consideration that is contingent upon the occurrence or non-occurrence of a particular event’ not being factors sufficiently important or identifiable to the general consumer, other problems with the New Zealand contingent definition of UP are that it does not appear to be fair or correct in a general sense.

#### **a. Fairness**

If a consumer asks the price of an item and they are then presented with a clear price tag, within the general meaning of fairness, the consumer cannot then protest that the price was an unfair surprise. The New Zealand contingent definition of UP however risks situations where within the general meaning of fairness, consumer protests relating to UP may be valid. Broadly speaking, if a term is at all associated with price, it will very likely be exempt from challenges of unfairness. However, ‘associated with price’ is a very wide concept and the likelihood of inherently unfair factors falling within the scope of this are highly likely. This is especially so when these factors include future events which the average consumer could not reasonably be expected to contemplate.

It has been suggested that generally terms that provide for additional consideration to be payable by the consumer contingent upon the occurrence or non-occurrence of some further event are often a source of perceived unfairness.<sup>398</sup> Unfairness of terms has been associated with terms which have the effect of surprise, or an unexpected ultimate outcome,<sup>399</sup> and it is terms which relate to a contingency that are inherently most susceptible to surprise. Another

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<sup>398</sup> *Abby National*, above n 363, at [17].

<sup>399</sup> Santucci, above n 37, 186.

indication of general unfairness is the likelihood of collateral harm from the provisions reaching beyond their intended purpose. With the general nature of a contingent concept being flexible enough for intended practical application, such a concept has the danger of flexing too far in the opposite unintended direction. Ideally a definition of an "examined term" should be flexible enough to exclude all the appropriate terms which consumers are routinely not examining and therefore not factoring into their decision as to whether or not to enter into the contract.<sup>400</sup> The New Zealand contingent definition of UP not only does not do this, but it takes the opposite approach, acting as a 'drift net' to catch anything that resembles price, even in its most abstract form. This creates a default position that any term relating to price is exempt from challenges of unfairness. Such a default position inevitably sacrifices fairness in favour of practical efficiency by reducing the unfair terms provision's scope for the operation of unfairness. Such a limitation must be incorrect, as this would undermine the whole policy underpinning the legislation.

#### **b. Correctness**

Finally, the New Zealand definition arguably falls short again in its general correctness. This argument stems from the general tendency for wide definitions which stretch beyond natural meanings to have the consequence of expanding beyond the intended meaning and therefore beyond the correct meaning. In the case of UP, the current wide definition being used in New Zealand has the potential to include factors which the policy of the provisions likely did not intend for its inclusion.<sup>401</sup> One indication of this is that the wide definition appears to create a conflict with the grey list of examples provided in the provisions to give the Courts guidance. Section 46M(c) of the FTA gives the example of a term that will always be unfair; being one that penalizes one party, but not the other, for a breach or termination of the contract. This appears to enable suppliers to include unfair payment terms that are clearly anticipated by Section 46M(c), so long as they are included in the UP. Since there is shown to be an illogical overlap in the definition, this cannot have been the intention of the provision drafters. It then follows that the definition is at very least, not *fully* correct.

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<sup>400</sup> Tokeley, 'Introducing a Prohibition on Unfair Contractual Terms into new Zealand Law: Justifications and Suggestions for Reform', above n 49, 434.

<sup>401</sup> Tokeley, 'A Critical Analysis of the Current Proposal', above n 323, at 119.



Due to the identified problems with the New Zealand definition of UP likely leading to unfairness to the general consumer, this section will now investigate a more appropriate definition which may lead to better protection for the general consumer should the UP exemption be relied upon.

## **B. An Appropriate Definition of Upfront Price**

As has been identified, the New Zealand contingent definition of UP has some problems, which all mainly stem from the inclusion of ‘any consideration that is contingent upon the occurrence or non-occurrence of a particular event’, resulting in the New Zealand definition being overall inclusive. It then follows that a definition which is exclusive would likely avoid many of those concerns. One obvious way to achieve exclusivity would be to completely remove the inclusion of contingencies from the definition. However, in doing this there is the danger that this may result in being at the expense of certainty and may create more problems than it solves.

The New Zealand definition has this advantage in certainty. Under the current New Zealand definition, any aspect of a product or service relating to price will fall under the UP exemption. In the context of what is subject to exemption from unfairness within a PL SFC in New Zealand, the definition of UP and the extent of the exclusion would include the amount borrowed, the interest payable, any fees associated with the service, as well as any fees or escalating interest associated with default or with the rolling over the loan. In other words, anything relating to price within the PL SFC. This is easy to understand as to where the practical line is to be drawn relating to UP and so can be efficiently administered and regulated. This certainty is a valuable quality and ought to be retained if possible.

The challenge then turns to developing a definition which retains the advantage of certainty, yet still addresses the concerns of over inclusiveness. In consideration of what may be an appropriate degree of exclusiveness, it is useful to examine the definition of UP which is used in the context of unfair terms provisions in other jurisdictions.

As has been previously stated in Section Three of this paper, the Australian unfair terms provisions were incorporated almost in their entirety into section 26A and sections 46H to 46M of the FTA. The Australian provisions were in turn modelled closely on those which were already in use in the United Kingdom. However, in each of these three jurisdictions, the definition of UP differs. This results in inconsistencies between the jurisdictions as to which specific factors fall within UP and are exempt from challenges to unfairness. An analysis of the strengths and weaknesses of the definition of UP in Australian and the United Kingdom will be useful in comparison to the New Zealand definition in determining whether altering New Zealand's definition would in fact assist in further promoting the underlying principles of the provisions. Since the United Kingdom was the first of the three jurisdictions to implement provisions exempting UP from challenges to unfairness, it is helpful to examine these first.

#### **(i) Upfront Price in the United Kingdom**

In the United Kingdom, the UP exemption is defined under the Unfair Terms in Consumer Contracts Regulations 1999 ("UTCCR 1999") in regulation 6(2) (b) as:

In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate- (b) to the adequacy of the price or remuneration, as against the goods or services supplied in exchange.

From this definition, there is no specific mention of contingency fees. Instead, only price is mentioned. It could be assumed that 'price' in this context relates to the natural meaning of the term. As discussed, it is the natural meaning of the term 'price' which is usually examined by consumers. If it was the natural meaning which was intended, then it is not only possible that the intention was to exclude fees and other penalties from forming the UP and falling under the exemption, but it was most likely the specific intention of the drafters. The problem however, is that it is not clear.

This exclusion of contingency fees within the definition would initially suggest an improvement on the New Zealand definition, as it does not make the default assumptions which the New Zealand definition does that consumers routinely identify, understand and hold importance to contingency fees. By this, the definition would impute that factors remotely contingent to the price of a product or service are not necessarily routinely examined by the general consumer. However, with not explicitly stating within the definition whether or not contingencies could form the UP, a vast degree of uncertainty is created as to the scope of the exclusion and extent to which it excludes a term from review.

To demonstrate how the lack of addressing contingency fees within a definition of UP can become a problem, it is useful to consider case law. The extent of the exclusion of UP in regulation 6(2) of the UTCCR 1999 was a contested issue in the United Kingdom Supreme Court case of *Office of Fair Trading v Abbey National plc*,<sup>402</sup> which concerned consumer bank fees and charges. Here, the Supreme Court upheld an appeal by a group of banks that offered 'fee free' banking. The court held that account fees and charges should be considered part of the 'price or remuneration' for the provision of the 'package of banking services',<sup>403</sup> so regulation 6(2) excluded the banks' charges from assessment for fairness under the UTCCR 1999.<sup>404</sup> This decision was in contrast to an earlier case of *Bairstow Eve London Central Ltd v Smith*<sup>405</sup>, where an unfair default rate of commission was found to not be part of the UP and not exempt from challenges of unfairness. However, in *Abbey National*, Lord Walker and Lord Mance were able to justify the departure from *Bairstow Eve* by drawing a distinction between the relevant bank charges, which they upheld as payment for a package of services due only in the event of default, and an unfair default rate of commission.<sup>406</sup>

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<sup>402</sup>[2009] UKSC 6, [2010] 1 AC 696 (United Kingdom Supreme Court). See also the decision in the Court of Appeal [2009] EWCA Civ, 116 [2009] 1 All ER (Comm) 1097; and at first instance [2008] EWHC (Comm Ct), [2008] 2 All ER (Comm) 625.

<sup>403</sup> *Abby National*, above n 402, at [47], per Lord Walker; at [89], per Lord Phillips.

<sup>404</sup> The Supreme Court in *Abby National* did not take a universal view on whether the charges were, in fact, 'contingent on any event'. Lord Phillips at [74]-[75] held that the bank charges were not prices levied in exchange for each individual transaction, while Lord Walker at [47] accepted that the charges were 'contingent', but considered that fact irrelevant to whether they formed part of the price as defined by the legislation. See Santucci, above n 37, at 187.

<sup>405</sup> [2004] EWHC 263, at [25]. In this case a term in a contract was held to be unfair where it required the consumer to pay an escalated rate of commission in the event of non-payment after ten days.

<sup>406</sup> *Abby National*, above n 402, at [43], per Lord Walker; at [102], [113], per Lord Mance.

This distinction drawn in *Abby National* between a default interest rate and a default fee in forming price which the majority's decision is based upon has been identified as being problematic for two reasons.<sup>407</sup> The first problem is in regards to unjustifiable widening of the term. The second problem is in regards to incorrect assumptions of consumer behaviour and abilities. Both problems however stem from the lack of certainty in the definition of UP created by not mentioning contingencies within the definition.

As for the first problem with the *Abby National* distinction, such a distinction relies on solving the uncertainty within the definition regarding contingencies by widening the interpretation of the definition. *Bairstow Eves* warned that where there is uncertainty in an exempted terms definition, the term 'must be given a restrictive interpretation; otherwise a coach and horses could be driven through the regulations'.<sup>408</sup> The warning in *Bairstow Eves* was given by Gross J, as His Honour believed that if a fee or charge can be made to appear as if it was part of the basic price paid, it would escape scrutiny under the unfair contract terms law.<sup>409</sup> Naturally, the wider the interpretation of UP, the easier it will be for suppliers to include anything loosely related to price within the exemption.<sup>410</sup> Case law in the United Kingdom has suggested that this is undesirable,<sup>411</sup> as a wide interpretation inhibits regulating substantive fairness, encourages litigation, creates more uncertainty for suppliers and renders the operation of the regulations less comprehensible to consumers.<sup>412</sup> This definition of UP will inevitably create ambiguity whenever fees are involved, and this ambiguity, as suggested by case law, will usually be to the advantage of the stronger party drafting the SFC.

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<sup>407</sup> Sims, above n 43, at 762.

<sup>408</sup> *Bairstow Eves*, above n 405, at [25].

<sup>409</sup> Sims, above n 43, at 762.

<sup>410</sup> This was also acknowledged by Lord Walker in *Abbey National* at [43] where his Honour approved Gross J's reasoning and warned that '[t]raders ought not to be able to outflank consumers by "drafting themselves" into a position where they can take advantage of a default provision'.

<sup>411</sup> Similar to the escalating interest rate provision, in *Kowalczyk*, above at n 352, it was identified by the court that a term was drafted to avoid the common law prohibition on penalties by providing an upfront discount which the consumer loses if he or she defaults on an obligation. It was found that this was in effect the same as imposing a penalty for late performance, but was able to circumvent the legislative provisions; In *Director General of Fair Trading v First National Bank plc*, above at n 358 Lord Bingham explained at 491 that: 'The object of the [UTCCR] is to protect consumers against the inclusion of unfair and prejudicial terms in standard form contracts into which they enter, and that object would plainly be frustrated if [the exemption provisions] were so broadly interpreted as to cover any terms other than those falling squarely within it.' See also Lord Steyn at 499-500; See also *Abby National*, above n 402, at [83]-[122], per Smith J.

<sup>412</sup> It has been submitted Sims that one way the courts could interpret 'upfront price' to avoid traders circumventing the unfair contract terms law by clever drafting would be to require the traders to set as the 'consideration' a fixed sum. See Sims, above n 43, 763.

The second problem with relying on the distinction made in *Abbey National* is that it fails to account for the consumer's perspective in approaching either type of contract term.<sup>413</sup> Lord Mance stated that 'the consumer is to be assumed to be capable of reading the relevant terms and identifying whatever is objectively the price.'<sup>414</sup> By this, Lord Mance suggests the consumer will, or at least ought to, 'give attention' to the price of the contract. However, it seems an unreasonable stretch of the term "give attention" to mean the general consumer will not only examine every aspect of what may likely constitute the price of the contract, but then also effectively examine everything that is not, and then finally distinguish between the two. This in effect requires the consumer to fully read and understand the entire SFC, which is a task that the provisions do not expect of the consumer. The fact that consumers do not read SFCs, as has been established, is precisely the justification on which the unfair terms provisions are based. It seems in this sense the United Kingdom's definition in excluding the mention of contingency fees not only fails to solve any of the problems identified with the New Zealand contingent definition, but is in fact a step backwards with introducing a large portion of uncertainty.

This controversy which has arisen in the United Kingdom emphasises the importance of certainty in an exempted UP definition. It is also evidence that simply excluding the mention of contingency fees does not solve any of the problems identified with the New Zealand UP definition. Instead, it would appear that contingency fees do need to be addressed within an appropriate definition. When Australia later introduced their unfair terms provisions, it has been noted that they had the problems which the United Kingdom had encountered regarding UP in mind.<sup>415</sup>

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<sup>413</sup> Santucci, above n 37, 188.

<sup>414</sup> *Abbey National*, above n 402, at [113].

<sup>415</sup> <sup>415</sup> The Australian Commonwealth Government was aware of the issues raised in *Abbey National* and the scope of the AUCTL was purposely broadened to enable courts to review the alleged unfairness of 'contingent' charges. As a result the Australian provisions will permit review of a wider range of contract terms. See Santucci, above n 37, 188- 189; See also Sims, above n 43, at 762.

**(ii) Upfront price in Australia**

Under the Australian legislation, UP is defined in section 26 (2) of the Competition and Consumer Act 2010 as;

26 (2) The upfront price payable under a consumer contract is the consideration that:

(a) is provided, or is to be provided, for the supply, sale or grant under the contract; and

(b) is disclosed at or before the time the contract is entered into; but does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event.

Through this definition of UP, Australia addressed the concerns of uncertainty which the United Kingdom encountered by drafting their provisions more precisely and with specific instructions for interpretation. In particular, contingencies have been addressed with the inclusion in section 26 (2) (b) by stating that UP ‘does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event.’ When compared, there are many similarities between the New Zealand and Australian provisions, however section 46K (2) of the New Zealand provisions present one obvious difference concerning the mention of contingency fees. With the inclusions of ‘does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event’, Australia has specifically excluded contingency payments from falling within the definition of UP. As discussed, the FTA has taken the opposite approach. Despite this difference achieving the opposite effect in regards to exemption of contingency fees, the shared fact that both New Zealand and Australia have specifically mentioned contingency fees presents a comparative advantage to both the Australian and New Zealand exclusion over that of the United Kingdom.

In Australia, any fees, even if the fees were to constitute the 'upfront price payable', will be challengeable. This is because any fees or escalating rates of interest are derived from the event of the consumer defaulting. They would then nevertheless constitute 'any other consideration that is contingent on the occurrence or non-occurrence of a particular event'. Therefore they will clearly not come under the exemption. Specifically in the context of what is subject to

exemption from unfairness within a PL SFC, in Australia, the definition of the UP would only include the amount borrowed, the interest payable and any fees associated with the service. Therefore, only these elements will be exempt from challenges of unfairness.

Despite this Australian definition being vastly superior in terms of its certainty over that of the United Kingdom, it does not completely eliminate all uncertainty to the same extent as the New Zealand definition. In Australia there may likely be instances where this definition will encounter problems due to the definition of contingency being so broad. One problem with this is that it could potentially be a very difficult task for courts to determine which terms might fall under the price exemption and which are better regarded as terms relating to obligations on default or some other type of contingent fee. One such example within the context of payday lending is determining whether losing an early repayment discount is associated with the service of lending funds, which falls under the exemption, or a fee contingent upon the occurrence of an event, which is not.

*Kowalczyk* identified that there are multiple ways to present a fee and that it is possible for a fee which would otherwise fall under contingency fees to be drafted in a way in which it achieves the same purpose as a contingency fee, yet by definition could be interpreted as a non-contingent fee.<sup>416</sup> The problem then with the Australian definition is that the certainty within the definition of UP relies on the certainty within the definition of contingency fee. If the drafters of SFCs are able to take advantage of this uncertainty inherent with contingency fees, then much of the certainty gained by explicitly excluding them may be lost. Under the New Zealand definition on the other hand, there would be no need to distinguish between a fee associate with a service and a fee contingent upon the occurrence of an event, as they will all be exempt from challenges.

This uncertainty identified in the Australian definition of UP follows to a more general, fundamental problem with the UP exemption. This being that UP is inherently a very broad term, regardless of whether the UP comprises of contingent components or not. UP will always to some degree need to be defined as "consideration payable under the contract". Due to this,

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<sup>416</sup> Above, at n 192. *Kowalczyk*, above, at n 352.

UP can never be a truly narrow term, as in a broad sense all the terms of a contract are in some way related to "consideration payable under the contract," as they all form part of the bargain that is supposedly being struck between the parties.<sup>417</sup> In this sense almost any term could then be drafted to form part of the price and exempt from challenges. This is especially so if the party drafting the SFC has at their disposal vast legal resources and there is a considerable advantage in excluding certain factors from challenges of unfairness. With 'consideration' being inherently a broadly defined legal concept, UP will also remain inherently broad.

This identified problem is especially pronounced with PL SFCs. When the SFC is a contract securing a line of credit, almost every term under the contract is associated with price to one extent or another. Whether the term is described as payment, costs, variations, information, or even notices, terminations or reminder letters, everything can be associated to the "consideration payable" under the loan agreement. For terms such as default and default interest which are clearly contingent events and specifically excluded from forming the UP under the Australian provisions, this can also be potentially circumvented for all practical purposes to bring them within the UP exemption.

Despite some loss of certainty in the Australian definition of UP and the acknowledgement that it still is susceptible to exploitation, it seems it will be considerably more beneficial to the general consumer when entering a credit contract compared to that currently in New Zealand. Under the Australian provisions, UP is exclusive and narrow, so close to the natural meaning of 'price'. UP will then be easy to understand, easily identifiable, and useful as a comparison tool. It will likely be one of the most important terms within the SFC, which the exemptions provisions assume, so will be examined. Due to these factors, the exemption to challenges to unfairness will be justified.

In a general sense of fairness, this definition also appears to make sense. Objectively extortionate fees, such as non-payment penalties and early termination fees, which are often out of proportion to the harm caused to the lender and objectively unfair, can be challenged.

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<sup>417</sup> Tokeley, 'A Critical Analysis of the Current Proposal', above n 323, at 119.



Finally, under the Australian definition there is no overlap within the provisions which lead to contradiction within the provisions, indicating it is also generally more correct. With the majority of the identified problems which New Zealand's definition possess when being applied to a PL SFC being largely solved by the Australian definition, it appears that this would be a better option for New Zealand's general consumers to use in the specific circumstance of PL SFCs.

If the underlying principle of the provisions is promoting and administering fairness, and it is to remain the dominant objective, then it is suggested that the exemption provisions ought to be amended to treat third tier consumer credit SFCs differently to other SFCs. One possibility is to amend the definition of UP in removing the inclusion of contingency fees when the contract involved is a third tier consumer credit SFC. With the suggested increased protection to the general consumer when entering a third tier consumer credit SFC established, this section now moves to suggested protection regarding the UP exemption for specifically the PB.

### **C. Upfront Price Exemption and the Payday Borrower**

From Part B of this section, it has been suggested that the narrow, fixed and natural definition of UP, like that used in Australia which explicitly excludes contingency fees, would be a more appropriate general definition of UP when using PL SFCs. It has been suggested that such a definition would be sufficient for the general consumer to adequately understand and would be used to influence their decision to enter the PL SFC. Therefore, with that definition being used, the UP exclusion from challenges of unfairness would then be justified and fair. However, where it can be established that a class of consumer does not routinely behave in the way of the general consumer, by fully and sufficiently examining price in its narrow, fixed and natural meaning, then that class of consumer may not receive the same benefit from the improved UP definition when entering a PL SFC. In this case, it is not simply the definition of UP which is the problem, but instead the concept of the UP exemption itself. As a result of this, for that class of consumer entering a PL SFC, any definition of UP used in the exemptions provisions may not be justified or fair, and may place that consumer at considerable risk.

As previously submitted, the PB is a class of consumer who routinely regards price differently to the general consumer. The way in which they do this is to not devote an adequate amount of importance to price when they enter SFCs. Due to this characteristic of PBs, it is likely they will continue to lack sufficient protection under the FTA, regardless of the UP definition. To demonstrate this, examining the current situation of the PB and Australian payday lending industry is an ideal indication of how the UP exemption fails the PB. Although the Australian payday lending industry is currently subject to the UP exemption using the more appropriate UP definition identified in Part B of this section, this has not appeared to hinder the payday lending industry or assist the PB.

In regards to how the new provisions in Australia have affected the payday lending industry, it seems it is business as usual. Although contingency fees in form have been successfully eliminated from exemptions to challenges of unfairness, many of these same fees in substance continue to be exempt from challenges. Through clever drafting, some fees which previously would have been included within terms falling under contingencies within PL SFCs have on instances been altered, replaced, or drafted differently so that the same fees in substance now forms part of the UP within the definition of the Australian unfair terms provisions. This then allows the terms to fall within the exemption provisions, as they are no longer technically a contingency to the UP. United Kingdom case law<sup>418</sup> has warned of this in its recommendation of a narrow definition for UP.

Examples of this are the recently introduced inclusions into SFCs by payday lenders in Australia of security cost fees, insurance fees and additional legal cost fees to be paid by particularly risky borrowers at the entering of the loan. All of these fees increase the total cost of the loan, and in a sense are there to cover the risk of default. Although default is a contingent factor, risk of default is not, so can technically be included as an administration fee.

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<sup>418</sup> *Abby National*, above n 236, at [43]; *Bairstow Eves*, above n 240, at [25].

It is also apparent in Australia that administration fees in general have increased, with account fees and account management fees spiking in recent years, possibly in response to default fees and default interest being challengeable. In the future it is probable that default fees and default interest could even be drafted out of PL SFCs due to their non-necessity in the payday lending business structure. One example of this is to charge default fees and default interest upfront as part of the administration fees, then refund a portion of the fees and interest should the borrower make repayments within the required timeframe.

Additional action that payday lenders in Australia have recently adopted is the practice of encouraging many of their high risk borrowers who request short term loans to extend the duration of their loan at the time of entering the contract.<sup>419</sup> The Australian Investments and Security Commission has suggested that often the lenders will threaten to refuse extending credit to the borrower if they do not accept a 12 month duration for the loan. This has drawn a warning from the Australian Investment and Securities Commission and a recommendation that further action needs to be taken in Australia to restrict unfair practices within the payday lending industry.<sup>420</sup> It is possible that this action taken by payday lenders is in part an anticipation of the availability of challenges to contingency fees affecting their profits. By extending the duration of the initial loan, profit lost from relying on the default interest and interest fees to maximise the total earnings from the loan can partially be recouped from extra interest charged over a longer period of time.

In regards to the effect of the Australian provisions on the PB, evidence suggests that UP definition is not the problem for the PB. In examining the experience of PBs in Australia since the inclusion of their unfair terms provisions, it appears that the use of a narrower fixed definition of UP has not assisted the average Australian PB to any substantially effect. Although more cost components of a PL SFC can be challenged, debt spirals and hardships associated with debt are in fact more rampant and more of a problem than ever. This has been identified as being due to the unfair terms provisions being ineffectual for the PBs, coupled

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<sup>419</sup> Payday lenders in Australia will now often encourage the borrower to enter the loan over a 12 month period. Before the inclusion of Australia's unfair terms provisions the usual duration of a short terms loan from a payday lender was less than 3 months.

<sup>420</sup> Australian Securities and Investment Commission. REPORT 426 Payday lenders and the new small amount lending provisions March 2015, 10.

with an increased number of desperate and financially excluded consumers in Australia.<sup>421</sup> There is no evidence to suggest the situation would be any different in New Zealand if Australia's more appropriate definition of UP was to be used. The problem is simply that the behaviour of the PB as a class of consumer is not compatible with behaviour expected within the concept of an UP exemption. This is due to altering the definition of UP not altering the circumstances or behaviour of the borrower, which is the real problem. Even if New Zealand legislation was amended to narrow the definition of UP, the improvement will likely have little practical value to the New Zealand PB. From this it may be fairly established that an UP exemption in any form will likely cause objective unfairness to PBs regardless of how the UP is presented.

If the payday borrower as a class of consumer was to be removed from the UP exemption under the FTA unfair terms provisions, this would likely be of substantial assistance in ensuring the PB receives a fair price for their credit, and this will be a big improvement in reducing hardship and debt spirals. It will also reduce the risk of payday lenders refusing to extend needed credit to excluded borrowers in the short term while there is still no alternative credit options in place for these borrowers. Since the PB as a class of consumer cannot be practically separated from the general consumer who uses PL SFCs, the proposed removal of PBs from the exemption provisions would need to be extended to all uses of PL SFCs, essentially treating third tier credit contracts as a separate category, as is done with the CCLAA. If this amendment was executed, it would likely be the best form of legislative consumer credit protection available to the PB in New Zealand.

This proposal is not perfect, and for it to be of any use the consumer would need to have the right to bring proceedings on their own rather than relying on the Commerce Commission. The factors which are important are that first the PB needs credit for both a fair and low price. The second is that they currently need lenders to continue advancing them credit. This proposal is not a real solution to the PB's problem, since the PB's real problem is poverty and social and financial exclusion. It is instead a solution to minimise hardship through creating an incentive

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<sup>421</sup> Mission Incomplete: A snapshot of consumer experiences of short term loans post the national consumer credit reforms Consumer Action Law Centre Amended July 2011. <https://consumeraction.org.au/wp-content/uploads/2012/01/MISSION-INCOMPLETE-amended-06072011>.

for the lender to want to give fairer credit options to the PB and stay in business, while also providing a recourse should the PB enter a crippling debt spiral. However, as stated, this is a temporary solution just until another credit option arises.

This leads to the consideration of the government giving serious thought to finally providing an alternative to third tier credit. Since many government public policies involve creating subsidies for consumer essentials, it would not be an excessive stretch to subsidise essential third tier credit in certain circumstances. As it now stands, the majority of PL SFCs are being used for household essentials, which means in New Zealand those at the bottom of society's financial echelon and less able to afford household essentials are paying the most for them.<sup>422</sup> It seems from this there is a strong public policy justification for action to finally be taken.

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<sup>422</sup> This result of poor people pay more for credit than the wealthy has been described by Malbon as a "rather nasty reverse Robin Hood effect" widening the gap between rich and poor, and making nonsense of public policies seeking to address poverty. See Malbon, above n 88, at 224.

## **7. CONCLUSION**

The recent enactment of the CCLAA introducing interest rate caps and cost of credit caps was an acknowledgement by the Government that vulnerable consumers like PBs have been suffering. This credit protection along with the substantive protection now available under the amendments to the FTA are a welcome improvement to the protection that was available a decade ago. These new consumer credit protection laws acknowledge that in New Zealand, just as in Australia, when it comes to “consumer transactions, unfair practices are widespread”,<sup>423</sup> and the vulnerable “...untrained consumer is no match for the businessman who attempts to persuade the consumer to buy goods or services on terms and conditions suitable to the vendor. The consumer needs protection by the law...”<sup>424</sup>

It has been submitted that PL SFCs are risky credit contracts, however there is a place for them. For the general consumer who requires an immediate cash advance, but also has the means to later repay the loan comfortably, it will likely be the right product for them. Now with the cost of credit caps and interest rate caps, these credit contracts will be a lot safer for them now than in the past. However, for the PB, it has been submitted that PL SFCs are never the right product for them, as they will only lead to increased detriment. For this borrower, it has been submitted that the cost of credit caps will not have the same effect of making them safer or reduce their potential hardship. It has been submitted that although a cap on credit will help, a maximum limit on credit does not equate to a fair price, which is what the PB needs. The caps also do not address the problem of these borrowers resorting to multiply loans from different lenders.

It has been suggested that in response to the caps, lenders are likely to increase the use of the WG term, using it now as more of a first response than a last resort. Although it is agreed that the WG term is likely a necessity to protect legitimate interests in a business which lends money

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<sup>423</sup> Speech of the Attorney General, senator the Hon LK Murphey QC, at the second reading of the Trade Practices Bill 1973 (No 2), Vol 57, 1013- 14.

<sup>424</sup> Ibid.

to risky borrowers, it has been suggested that the way it is currently being used is unfair. It has been suggested that the use of this term causes substantially hardship to PBs and the way it is used ought to be restricted to the way garnishment is used in employment contracts, with actual consent and consultation.

The second criticism of the cost of credit caps is that it is too much too soon. It has been submitted that credit is a need for all consumers. For PBs who are financially excluded, they currently rely on payday loans. If the payday lenders leave the market or become overly exclusive in their lending, many PBs will be cut off from all forms of credit. It has been suggested that this could mean their situation suddenly becomes worse than it would have been if they had gotten the loan. There are indications in Australia that the payday lending industry is already becoming more selective and exclusive in their lending. In Australia, Cash Converters, Money3 and Nimble, being the lenders which dominate the industry in Australia, do not extend loans to borrowers where their primary source of income is from Centrelink.<sup>425</sup>

It is possible that not extending credit to beneficiaries or those on very small and fixed incomes is a positive step forward, however it does not really provide any assistance to those consumers requiring fair and affordable credit. Although borrowing funds which may lead to later detriment will logically be seen as undesirable and exacerbating the problems of those on low incomes, this does not equate to essentials no longer being essentials if the consumer has difficulty paying for them. The goal should not be to exclude PBs from bad credit, but to provide PBs with fair credit.

It has been suggested the best consumer credit protection to achieve a fair price for credit for the PB is through the unfair terms provisions of the FTA, which has fairness as its grounding principle. The suggested use of the unfair terms provisions is to treat UP as a non-exempt term through an amendment to the exemption provisions, allowing UP to be challenged for unfairness in the case of all third tier credit SFCs. It is suggested that this does not undermine the provision's justification for the exemption, as in the case of the PB entering a PL SFC, the

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<sup>425</sup> Centrelink is the Australian Department of Human Services government program which disburses government payments including unemployment benefits, disability benefits and social security payments.

justifications for the exemption is not present. It has been suggested that the PB ought to qualify as a separate class of consumer for the purposes of credit contract protection. In doing this, it brings the provisions closer to their objective of fairness by analysing the reality of current situations and adapting to that, rather than identifying the ideal and pursuing it at the expense of the most vulnerable. This places the emphasis on the correct reality of a situation, rather than the incorrect ideal.

Although not all users of third tier credit meet the standard of consumer that justifies being excluded from the UP exemption like the PB, for workability the amendment would have to focus on the credit contract and not the class of borrower. Though this, the advantages gained will be that lenders will be more likely to first, offer fairer credit terms due to the risk of an unfair price leading to the credit contract being re-opened. Second, will be less likely to refuse credit to those who still rely on it. It has been suggested that although there will be no safety net maximum limit, there will potentially be a gain for the borrower with the risk of debt spirals being removed. In order for this to work however, there would also need to be restrictions on the use of the WG term and consumers would need the right to bring proceedings on their own, rather than rely on the Commerce Commission.

It has been stated that the lenders are not the problem for the PB. The problem is poverty, low incomes and financial exclusion, which places the PB in a position where they enter PL SFCs involuntarily. Consumer credit protection will only ever be a temporary solution for these consumers. There is no credit protection that can prevent you from needing money you do not have. Although we all need help through credit, whether it is a personal loan, mortgage, student loan or business loan, it seems the ones who need the most help get the least.

Since my days of needing a loan to fix my car, my situation has improved. However, in order to submit this paper I was required to pay additions fees. The amount was more than I had and I needed to pay it fast. I did not need a PL though. I instead borrowed from a friend, who charged me no interest and said I could pay it back whenever I wanted. In fact I had over a dozen people I could have asked who would have given me the money I wanted no questions asked. What is more, they would never chase me for it, even if I could not pay it back. But I



am not a PB. I am lucky. Many in New Zealand are not, and when it comes to the PL SFC they must “take it”. All they have is the hope that the consumer credit protections will ease a little of their hardship... and the hope that one day they will have the choice to “leave it.”

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